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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

In Re: HUGO NERY BONILLA, Debtor.	District Case No. CV 08-1062 WHA
ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	Adversary Proceeding No. 07-03079 (Bky. Ct. Case No. 07-30309) Chapter 7 REQUEST OF APPELLANT HUGO NERY BONILLA FOR CERTIFICATION OF APPEAL TO THE NINTH CIRCUIT COURT OF APPEAL

TO THE HONORABLE WILLIAM H. ALSUP, UNITED STATES DISTRICT COURT JUDGE FOR THE NORTHERN DISTRICT OF CALIFORNIA:

Appellant Hugo Nery Bonilla hereby requests that this court certify this matter for direct appeal to the Ninth Circuit Court of Appeals pursuant to 28 U.S.C. § 158(d)(2) based on the following:

I. INTRODUCTION

This is an appeal from a bankruptcy court order that conflicts with well-settled precedent of both the United States Supreme Court and the Ninth Circuit Court of Appeals concerning the meaning of 11 U.S.C. § 523(a)(4), which excepts from discharge debts incurred "for fraud or

defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Bankruptcy law narrowly applies this exception only to those instances where the debtor was a fiduciary pursuant to an express or statutory trust.[1] Because the bankruptcy "fresh start" policy requires that exceptions to discharge be construed strictly against the objecting creditor, the traditional application of § 523(a)(4) is quite narrow, as follows:

> "§ 523(a)(4) is aimed only at the express trust situation in which the debtor either expressly signified his intention at the outset of the transaction, or was clearly put on notice by some document in existence at the outset, that he was undertaking the special responsibilities of a trustee to account for his actions over and above the normal obligations that contracting parties have to each other in a commercial transaction."[2]

The bankruptcy court explicitly departed from precedent and bankruptcy policy by expanding the "express or statutory trust" factor to include those situations in which the debtor's fiduciary duties are "substantially similar" to those of a trustee of an express or technical trust, even where there is none. Accordingly, the court's Partial Summary Judgment, based upon the court's ruling that as a director of a Delaware corporation, Bonilla was a "fiduciary" under § 523(a)(4), must be reversed.

Under 28 U.S.C. § 158(d)(2), this appeal is proper for certification to the Ninth Circuit because (1) there is no controlling decision on the issue of whether a Delaware director is a "fiduciary" under § 523(a)(4) from the Ninth Circuit or from the United States Supreme Court, (2) there are conflicting decisions on this issue among the bankruptcy courts and (3) because an immediate appeal to the Ninth Circuit will materially advance the progress of the debtor's case as well as the proceeding.

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[1] See e.g. *Blyler v. Hemmeter (In re Hemmeter)*, 242 F.3d 1186, 1189 (9th Cir. 2001); *Newsom v. Moore (In re Moore)*, 186 B.R. 962, 974 (Bankr. N.D. Cal. 1995).

[2] *Spinoso v. Heilman (In re Heilman)*, 241 B.R. 137, 160 (Bankr. Md. 1999), citing *Bamco 18 v. Reeves (In re Reeves)*, 124 B.R. 5, 10 (Bankr. D. N.H. 1990); see also 4 Collier On Bankruptcy (15th ed. rev.) at ¶ 523.05.

II. HISTORY OF THE DISPUTE BETWEEN ATR AND BONILLA

This history of this case shows that Bonilla's debt to ATR does not implicate 11 U.S.C. § 523(a)(4) because there was no express trust situation between Bonilla and ATR, whereupon Bonilla "either expressly signified his intention at the outset of the transaction, or was clearly put on notice by some document in existence at the outset, that he was undertaking the special responsibilities of a trustee to account for his actions over and above the normal obligations that contracting parties have to each other in a commercial transaction."[3] Instead, ATR's claim arises from a judgment entered on December 21, 2006 by Delaware Chancery Court ("the Delaware Judgment") in the matter of *ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. v. Carlos R. Araneta, et al*., Delaware Court of Chancery No. ICV.A. 489-A, subjecting Bonilla jointly and severally liable to Plaintiffs ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. (collectively, "ATR") for approximately $24.5 million. (Exhibit "A" (*ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. v. Carlos R. Araneta, et al*., Delaware Court of Chancery No. ICV.A. 489-A).) The Delaware Chancery Court found that, as director of corporation known as PMHI, Bonilla did not participate in, approve of, or directly profit from wrongdoing by the majority shareholder. (Ex. "A"). Bonilla's liability stems from the Court's finding that he breached his duty of loyalty to PMHI by failing to "monitor the potential that others within the organization will violate their duties," which, in turn, imposes upon directors a duty to try "'in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists.'" Ex. "A" at p.19, citing *Caremark, Int'l, Inc. Deriv. Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996). In other words, the Chancery Court ruled that Bonilla breached the general corporate fiduciary duties imposed on all corporate directors, but did not make findings that he was a trustee of the corporate funds, nor that he did violated the terms of previously-agreed upon agreement between the directors and the shareholders whereupon the directors are impressed with special responsibilities beyond those of all other corporate directors.

[3] *In re Heilman*, 241 B.R. 137, 160, citing *In re Reeves*, 124 B.R. 5, 10.

Bonilla filed chapter 7 bankruptcy because ATR's judgment of $24.5 million far exceeded the amount that he could ever be expected pay. Bonilla is a hard-working man who has been employed for 20 years by LBC Holdings, U.S.A. Corporation and LBC Mundial Corporation, businesses engaged in money remittance and cargo shipment. His monthly net income of $7,498 supports his large family, and is barely enough to cover his family's monthly expenses.

On July 23, 2007, ATR filed the underlying adversary proceeding. (Ex. "B" (Complaint)). Bonilla promptly moved to dismiss ATR's fourth claim for relief, which alleges that the Delaware Judgment is non-dischargeable under § 523(a)(4), on the grounds that ATR did not and cannot allege the elements required under § 523(a)(4). (Ex. "C" (Memorandum of Points and Authorities Supporting Motion to Dismiss Complaint)). Specifically, the Chancery Court did not find that Bonilla was a fiduciary to ATR pursuant to an express or statutory trust under Delaware state law. Rather, the Chancery Court found that Bonilla breached his fiduciary duties to ATR under Delaware corporate law. Those duties fell within the realm of the broad and general definition of a fiduciary, which is inapplicable to the dischargeability context and are not sufficient to support a § 523(a)(4) claim.[4]

In support of his motion to dismiss, Bonilla analyzed the two cases which have ruled on the issue of whether a director of a business incorporated in Delaware is a "fiduciary" under § 523(a)(4), namely, *Miramar Resources, Inc. v. Arthur Shultz (In re Arthur Shultz)*, 208 B.R. 723 (Bankr. M.D. Fl. 1997) and *Miramar Resources, Inc. v. Zachary L. Shultz (In re Zachary Shultz)*, 205 B.R. 952 (Bankr. N.M. 1997), and argued that only the *Arthur Shultz* decision complied with precedent mandating a finding of fiduciary duties imposed under an express trust under a § 523(a)(4) claim for relief. The *Arthur Shultz* court reviewed and analyzed Delaware corporate law, and found that "there is Delaware case law that states 'corporate officers and directors, while technically not trustees, stand in a fiduciary relation to the corporation and its stockholders.'" *Arthur Shultz* at 729, citing *Bovay v. H.M. Byllesby & Co*, 27 Del. Ch. 381, 38 A.2d 808, 813 (Del. 1944)(citing *Guth v.*

[4] "The broad, general definition of fiduciary – a relationship involving confidence, trust and good faith – is inapplicable to the dischargeability context." *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986).

Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503, 510 (Del. 1939). "Therefore, as a director of Miramar, Defendant may have been a fiduciary, but not a trustee under traditional Delaware corporate doctrine." *Arthur Shultz* at 729. The court concluded that Delaware law does not impose an express or statutory trust on corporate directors and thus, § 523(a)(4) is inapplicable.

The *Arthur Shultz* court ultimately ruled that the only situation in which a Delaware director may be deemed a "fiduciary" under § 523(a)(4) is in cases where the Delaware Trust Fund Doctrine, which arises when a corporation becomes insolvent as a result of the director's wrongdoing, is implicated. But Bonilla disputes this analysis because the Delaware Trust Fund Doctrine imposes a *constructive trust*, rather than a true trust, as an equitable remedy where corporate directors profit from their wrongdoing.[5] Thus, even if the Delaware Trust Fund Doctrine is implicated, it does not meet the § 523(a)(4) strict requirement for an express or statutory trust.[6]

Bonilla also argued that the second case on point, *Miramar Resources, Inc. v. Zachary L. Shultz (In re Zachary Shultz)*, 205 B.R. 952 (Bankr. N.M. 1997), which ruled that Delaware directors are "fiduciaries" under § 523(a)(4), does not comport with the strict "express trust" requirement of § 523(a)(4). The *Zachary Shultz* court determined that the "express trust" requirement is simply not required in § 523(a)(4) suits against corporate directors. *Zachary Shultz* at 958, citing *In re Snyder*, 101 B.R. 822, 835 (Bankr. Mass. 1989). Instead, § 523(a)(4) denies discharge of a debt owed by a corporate director if the debt was "created by the person who was already a fiduciary at the time the debt was created.'" *Zachary Shultz* at 958, citing *In re Snyder*, 101 B.R. at 835.

ATR opposed Bonilla's motion to dismiss, urging the court to adopt a new test for liability under § 523(a)(4), namely, that a debt may be deemed nondischargeable if "trust-like" duties were imposed by state common-law. (Ex. "D" (Memorandum of Points and Authorities in Opposition to Defendant's Motion to Dismiss Fourth Cause of Action Pursuant to Federal Rule of Civil Procedure

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[5] *Decker v. Mitchell (In re JTS Corp.)*, 305 B.R. 529, 535 (Bankr. N.D. Cal. 2003).

[6] "We have adhered to this construction in interpreting the scope of 11 U.S.C. § 523(a)(4), refusing to deny discharge to those whose fiduciary duties were established by constructive, resulting and implied trusts." *In re Hemmeter*, 242 F.3d at 1189-90, citing *Runnion v. Pedrazzini (In re Padrazzini)*, 644 F.2d 756, 758 (9th Cir. 1981) and *Schlecht v. Thornton (In re Thornton)*, 544 F.2d 1005, 1007 (9th Cir. 1976).

12(b)(6))). ATR stated that its "trust-like duties" test is supported by *Lewis v. Scott (In re Lewis)*, 97 F.3d 1182 (9th Cir. 1996), which ruled that Arizona *partners* are fiduciaries under § 523(a)(4), and that Delaware law imposes trust-like duties on its corporate directors. ATR distinguished *In re Cantrell*, 329 F.3d 1119 (9th Cir. 2003), which determined that California corporate directors are not fiduciaries under § 523(a)(4), on the grounds that duties imposed on California corporate directors are grounded in agency law, but which did not mention a "trust-like duties" test. In contrast, the duties imposed on Delaware corporate directors are grounded in trust law. ATR failed to explain that *Cantrell* did not make this distinction and failed to explain why, if the Ninth Circuit has adopted a "trust-like duties" test, it has not applied this test even once in the twelve years since *Lewis* was issued.

On October 16, 2007, the bankruptcy court issued an order denying Bonilla's motion to dismiss. (Ex. "E" (Order Denying Defendant's Motion To Dismiss Plaintiff's Fourth Claim For Relief)). The court also issued a Memorandum Re Defendant's Rule 12(b)(6) Motion (Ex. "F"), setting forth the court's findings of fact and conclusions of law. The Memorandum appears to state that Delaware law is in conflict on the issue of whether a corporate director is a trustee: while the court found that "numerous Delaware decisions refer to directors as trustees", the court also found that "Delaware court decisions do not, however, equate corporate directors with trustees in all respects." The Memorandum fails to address the fact that in *Bovay v. H.M. Byllesby & Co.*, 27 Del.Ch. 381, 393, 38 A.2d 808 (1944), the Delaware Supreme Court clarified that directors are not trustees. But under limited circumstances, such as upon a corporation's insolvency or, as in the *Keenan* matter, upon their wrongdoing, a court may impose trustee duties on directors. The Memorandum does not cite Delaware law imposing higher or trustee duties on its corporate directors outside of the insolvency or wrongdoing exceptions.

In support of its decision to adopt the "substantially similar" test, which no decision from the United States Supreme Court or the Ninth Circuit Court of Appeals has even mentioned, the court relied upon *Lewis*, 97 F.3d 1182. The Memorandum states that *Lewis* was grounded in "state-court decisions that imposed on partners the duties of loyalty, honesty, and fair dealing," case law describing a partner's duties as similar to a trustee's, and statements in COLLIER ON BANKRUPTCY

that "the duties of the fiduciary need only be 'substantially similar' to those imposed on trustees." But by relying so heavily on *Lewis*, the court overlooked several material facts, namely: (1) that *Lewis* does not state that pursuant to its decision, the Ninth Circuit is now deviating from its established, narrow interpretation of "fiduciary" under § 523(a)(4) by adopting a more expansive "substantially similar" test; (2) that even if Lewis adopted a "substantially similar" test, then *Lewis* is an anomaly in the Ninth Circuit, as no other Ninth Circuit case has applied this test; (3) that *Cantrell*, discussed in both parties' briefs, refused to extend its decisions pertaining to partners under § 523(a)(4) to corporate directors; (4) that *Lewis* simply followed the Ninth Circuit's prior decision in *Ragsdale v. Haller*, 780 F.2d 794 (9th Cir. 1986), in which the Ninth Circuit found that under California law, all partners are trustees over the assets of the partnership and thus, that California partners are fiduciaries under § 523(a)(4); and (5) that *Lewis* was grounded on uncontroverted Arizona partnership state law.

Based on the foregoing, Bonilla moved for reconsideration (Ex. "G"), which ATR opposed (Ex. "H"). ATR also filed a Motion For Summary Judgment on its fourth claim for relief (Ex. "I"), and both matters were set for hearing on December 14, 2007.

At the hearing, the court denied Bonilla's motion for reconsideration, and granted ATR's motion for summary judgment. Thereafter, the court issued a Memorandum Re Defendant's Motion for Reconsideration and Plaintiffs' Motion for Summary Judgment (Ex. "J"), an Order Denying Defendant's Motion For Reconsideration and Granting Plaintiffs' Motion For Summary Judgment On Fourth Cause Of Action (Ex. "K"), as well as a Partial Summary Judgment on Fourth Cause of Action and Rule 54(b) Certification (Ex. "L"), which Bonilla appealed on January 9, 2008.

III. CERTIFICATION TO THE NINTH CIRCUIT COURT OF APPEALS IS PROPER UNDER 28 U.S.C. § 158(d)

A. 28 U.S.C. § 158(d) Mandates Certification To The Ninth Circuit

The Ninth Circuit *shall* have jurisdiction over an appeal:

> if … the district court … acting on its own motion or on the request of a party to the judgment … certif[ies] that
> (i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;

> (ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions;
> or
> (iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken;
> *and* if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

28 U.S.C. § 158(d)(2)(A), italics added. Although Bonilla only needs to establish that subsections (i) and (ii) are indicated, or, alternatively, that subsection (iii) is indicated, he will establish that in fact, all three subsections of § 158(d)(2)(A) are indicated and thus, certification to the Ninth Circuit is proper, as follows:

i. <u>There Is No Controlling Decision From The Ninth Circuit Or The Supreme Court Of The United States On The Issue Of Whether A Delaware Corporate Director Is A "Fiduciary" Within The Meaning Of 11 U.S.C. § 523(a)(4)</u>

The issue on appeal in this is whether a Delaware corporate director, such as the Appellant, qualifies as a "fiduciary" within the meaning of 11 U.S.C. § 523(a)(4). It is undisputed that neither the Ninth Circuit Court of Appeals nor the United States Supreme Court have reviewed or determined whether a director of a corporation incorporated in Delaware is a "fiduciary" within the meaning of 11 U.S.C. § 523(a)(4).

Accordingly, subsection (i) of 28 U.S.C. § 158(d)(2)(A) is satisfied.

ii. <u>The Judgment Involves Questions Of Law Requiring Resolution Of Conflicting Decisions</u>

With respect to the first issue, two courts have decided whether a Delaware corporate director is a "fiduciary" under 11 U.S.C. § 523(a)(4):

a. *Miramar Resources, Inc. v. Arthur C. Shultz (In re Arthur Shultz)*, 208 B.R. 723 (Bankr. M.D. Fl. 1997)(Delaware directors are not "fiduciaries" under 11 U.S.C. § 523(a)(4)).

b. *Miramar Resources, Inc. v. Zachary L. Shultz (In re Zachary Shultz)*, 205 B.R. 952 (Bankr. N.M. 1997)(Delaware directors are "fiduciaries" under 11 U.S.C. § 523(a)(4))

Accordingly, both subsections (i) and (ii) of 28 U.S.C. § 158(d)(2)(A) are satisfied, and thus, Bonilla has established that certification to the Ninth Circuit is appropriate. But certification is proper under subsection (iii) as well:

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iii. Immediate Appeal From The Judgment May Materially Advance The Progress Of The Proceeding In Which The Appeal Is Taken

Immediate appeal from the court's judgment will materially advance the progress of the adversary proceeding, which pertains to the dischargeability of a $24 million judgment against Bonilla. The parties have stipulated to stay enforcement of the judgment pending resolution of the appeal, but requiring the parties to wait until the district court renders a decision on the matter, followed by an inevitable appeal to the Ninth Circuit, will be highly burdensome to both parties in this matter.

Based on the foregoing, Bonilla has established that certifying this appeal to the Ninth Circuit is warranted under 28 U.S.C. § 158(d)(2)(A).

B. The Request For Certification Is Properly Filed With The District Court Because The Appeal Is Pending Before the District Court

A matter is deemed to be "pending" in either the bankruptcy court, Bankruptcy Appellate Panel, or the district court "until the docketing, in accordance with Rule 8007(b), of an appeal taken under 28 U.S.C. § 158(a)(1) or (2)." Fed. R. Bankr. Proc. 8001(f)(2). Rule 8007(b), which pertains to the docketing of the appeal, states that "when the record is complete for purposes of the appeal, the clerk shall transmit a copy thereof forthwith to the clerk of the district court or the clerk of the bankruptcy appellate panel."

On January 31, 2008, the bankruptcy clerk filed the Notice of Transfer of Appeal to District Court and on February 12, 2008, the bankruptcy court filed its notice of transmittal of record on appeal to the district court. Accordingly, this matter is pending before the district court, and thus, the request for certification is properly filed with the district court.

C. The Request For Certification Is Timely

Under 28 U.S.C. § 158(d)(2)(E), "[a]ny request … for certification shall be made not later than 60 days after the entry of the judgment, order, or decree." The bankruptcy court entered the Partial Summary Judgment being appealed on January 2, 2008, and thus, the deadline to file the request is March 2, 2008. Accordingly, this request, having been filed on February 26, 2008, is timely.

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IV. CONCLUSION

Based on the foregoing, certification to the Ninth Circuit is proper under 28 U.S.C. § 158(d)(2)(A). The bankruptcy court's decision to adopt its "substantially similar" test, rather than complying with precedent from the United States Supreme Court and the Ninth Circuit requiring that the moving party establish that the debtor was a fiduciary pursuant to an express or technical trust, constitutes a radical departure from established law which will have enormous impact on all Delaware corporate directors. This is thus a matter of high importance to corporate directors everywhere, necessitating immediate review by the Ninth Circuit. Accordingly, Appellant prays that this court grant his request for certification to the Ninth Circuit.

DATED: February 26, 2008

MACDONALD & ASSOCIATES

By: /s/
Heather A. Cutler, Attorneys for Defendant, Hugo Nery Bonilla

Westlaw.
Not Reported in A.2d
Not Reported in A.2d, 2006 WL 3783520 (Del.Ch.)
(Cite as: Not Reported in A.2d)

C
ATR-Kim Eng Financial Corp. v. Araneta
Del.Ch.,2006.
Only the Westlaw citation is currently available.
UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.

ATR-KIM ENG FINANCIAL CORPORATION, and ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs,
v.
Carlos R. ARANETA, Hugo Bonilla, Liza Berenguer and Marites Vicente, Defendants,
andPMHI HOLDINGS CORPORATION, (f/k/a LBC Global Corporation), a Delaware corporation, Nominal Defendant.

No. CIV.A. 489-N.

Submitted: Oct. 9, 2006.
Decided: Dec. 21, 2006.

Steven T. Margolin, Esquire, Richard D. Heins, Esquire, Ashby & Geddes, Wilmington, Delaware; Sidney Todres, Esquire, Epstein Becker & Green P.C., New York, NY, for Plaintiff.
Richard D. Allen, Esquire, Thomas W. Briggs, Jr., Esquire, Morris, Nichols, Arsht & Tunnell LLP, Wilmington, for Defendants.

MEMORANDUM OPINION
STRINE, Vice Chancellor.

I. *Introduction*

*1 Plaintiffs ATR-Kim Eng Financial Corp. ("ATR Financial") and ATR-Kim Eng Capital Partners, Inc. ("ATR Capital") (collectively, "ATR") own 10% of the shares of a holding company-PMHI Holdings Corp. (f/k/a LBC Global Corp.) (the "Delaware Holding Company"). ATR claims that defendant Carlos Araneta, who controlled the remaining 90% of the Delaware Holding Company's equity and served as chairman of its board, caused the corporation to transfer its key assets-its ownership of several businesses worth over $35 million (the "LBC Operating Companies")-to members of his family in violation of his fiduciary duties. The Delaware Holding Company was formed precisely to enable ATR to share with Araneta in the benefits of owning the LBC Operating Companies. But, after Araneta denuded the Delaware Holding Company of those assets, ATR was left with only a minority stock ownership position in a floundering joint venture that it had undertaken with Araneta, a position that is worth very little. Meanwhile, Araneta and his family were left with sole control of the LBC Operating Companies, which, from the record, appear to be thriving.

Furthermore, ATR claims that the other members of the board of directors of the Delaware Holding Company, defendants Hugo Bonilla and Liza Berenguer, are jointly and severally liable for this harm because they failed to take any steps to monitor Araneta and prevent his self-dealing. Bonilla was the head of Araneta's operations in the United States, and Berenguer served as the Chief Financial Officer of his worldwide enterprise. They essentially admit that they regarded themselves as mere employees of Araneta and failed to take any steps to fulfill their fiduciary duties to the Delaware Holding Company. As directors, they were charged with protecting the interests of their corporation and its stockholders. Yet, Bonilla and Berenguer allowed Araneta to do whatever he wanted, without any examination of whether his conduct benefited the Delaware Holding Company and all of its stockholders, rather than simply Araneta personally.

In this post-trial opinion, I find that Araneta breached his duty of loyalty by impoverishing the Delaware Holding Company for his own personal enrichment. Bonilla and Berenguer also breached their duty of loyalty. Having assumed the important fiduciary duties that come with a directorship in a Delaware corporation, Bonilla and Berenguer acted as-no other word captures it so accurately-stooges for Araneta, seeking to please him and only him, and having no regard for their obligations to act loyally towards the corporation and all of its stockholders. Such behavior is not indicative of a good faith error in judgment; it reflects a conscious decision to approach one's role in a faithless manner by acting as a tool of a particular

EXHIBIT A

stockholder rather than an independent and impartial fiduciary honestly seeking to make decisions for the best interests of the corporation. Although it is clearly the case that Araneta is the most culpable of the defendants, Bonilla and Berenguer are accountable for their complicity in his wrongful endeavors.

*2 To the point of Araneta's misconduct, the sad reality is that his behavior as a director of the Delaware Holding Company and as a defendant in this litigation clearly manifests: (1) an intent on his part to defraud and injure ATR by consummating a de facto liquidation of the Delaware Holding Company in which its value was siphoned out entirely to the Araneta family, to the exclusion of ATR; (2) a willingness to put an innocent administrative employee of his at risk by falsely suggesting that she alone (rather than Araneta, Bonilla, and Berenguer as a group) comprised the board of directors of the Delaware Holding Company at the time Araneta impoverished it, all in a cynical attempt to avoid this court's jurisdiction and accountability for his own actions; (3) a contempt for the judicial process by providing a false and incomplete response to a legitimate demand for books and records under 8 *Del. C.* § 220; (4) a desire to obstruct the efficient procession of this litigation by making the discovery process unduly expensive and by failing to promptly produce required discovery; and (5) a shamelessness about telling lies so extreme as to make it impossible to address all of the numerous false statements and assertions he made both from his own lips and through theories he provided to his counsel.

Because of the difficulty of implementing a remedy that would undo the de facto liquidation of the Delaware Holding Company that Araneta effected, I enter an order requiring Araneta to pay to ATR a judgment based on the price ATR originally paid for its 10% equity stake in the Delaware Holding Company, plus pre-judgment and post-judgment interest pegged to a cost of capital determined by reference to an agreement between Araneta and ATR that provides the most reliable benchmark of the interest rate required to make ATR whole and to avoid unjustly enriching Araneta. This judgment may well understate the relief due ATR, as it appears that the LBC Operating Companies are booming. But ATR is willing to accept this more limited remedy and it is the most efficient means of providing it fair recourse.

Given Araneta's egregious misconduct both before and during this litigation, fee shifting under the bad faith exception to the American Rule is in order. Only through such an award will ATR be made whole for the excessive costs it had to incur in order to address Araneta's faithless acts, and only through such an award will Araneta's misuse of a Delaware corporation be rectified. The fee shifting award will also extend to any collection efforts ATR must expend in attempting to collect on this judgment.

Bonilla and Berenguer will be held jointly and severally liable for the monetary judgment but not for the fee-shifting award.

II. *Factual Background*

These are the facts as I find them after trial.[FN1]

> FN1. Citations to plaintiffs' exhibits ("PX ___"), defendants' exhibits ("DX ___"), or the trial transcript ("Tr. at ___") are illustrative. Other portions of the record often support the same findings.

A. *Overview Of The Key Arrangements Between Araneta And ATR*

Before describing the origins of the current dispute between ATR and Araneta in more detail, it is useful to provide a basic overview of the parties and how they came to form the Delaware Holding Company.

*3 Araneta first met ATR's chairman Ramon Arnaiz when they were in kindergarten in the Philippines. During their school days, Araneta and Arnaiz became close friends. After many years of friendship, the two fell out of touch as each embarked on his own career.

Araneta left the Philippines to attend college in the United States. After completing his studies, Araneta returned home to work in his family's business-an empire of companies run from the Philippines that share the initials LBC in their names (collectively, "LBC").[FN2] Araneta gained prominence by developing LBC Express, Inc. (f/k/a LBC Air Cargo), a Phil-

ippine version of Federal Express, into an international money remittance business that facilitates and profits from wire transfers made by Filipino expatriates who have gone abroad to make a living but continue to support their families still living in the Philippines. As a result of his efforts, Araneta came to dominate and control LBC and is the ultimate manager for the thousands of employees working for LBC and the hundreds of locations owned by LBC around the globe.[FN3]

> FN2. LBC Development Corp., a corporation organized and existing under the laws of the Philippines, was the primary holding company for the Araneta family businesses before the events giving rise to this dispute. Through this entity, the Aranetas owned the non-U.S. LBC Operating Companies that provided courier and money remittance services in the Philippines and to Filipino expatriates working in other nations. These entities include the following companies and their subsidiaries: LBC Domestic Franchise Co., Inc., LBC Express, Inc., LBC Mabuhay Development Philippine Corp., LBC International, Inc., and LBC Development Bank. The Aranetas also own LBC Holdings USA Corp. (overseen by defendant Bonilla), which serves Filipinos working in the United States.
>
> FN3. Although Araneta has at various times used his children to directly hold stock in the LBC Operating Companies, his children are subject to his will as to these matters. Araneta exercises de facto and clear control over his family's worldwide holdings.

Meanwhile, Arnaiz went into the financial services field. He gained prominence by spearheading the revitalization of a major financial firm's Hong Kong office. Following that success, Arnaiz ("A"), along with Manuel Tordesillas ("T") and Lorenzo Roxas ("R"), founded ATR, a Philippine corporation licensed to provide investment and financial services From its creation, ATR has been essentially a capital provider, helping businesses raise capital and investing its own funds (and those of its investors) in various enterprises.

In the late 1990s, Araneta and Arnaiz reunited. At that time, Araneta turned to Arnaiz and ATR for investment banking assistance on behalf of his LBC enterprise. Initially, Araneta engaged ATR to search for capital and to prepare LBC for a public offering. After a while, however, the relationship changed.

In 1999, ATR began investigating an opportunity to purchase a controlling interest in The Professional Group Plans, Inc., a corporation that sold "pre-need" insurance policies designed to cover expenses (such as educational and health costs) that buyers expected to face in the future (the "Pre-Need Company").[FN4] Seeing potential synergies in this industry between ATR's financial acumen and LBC's logistical network, which was well-positioned to attract Filipino customers who had traditionally purchased these policies, Arnaiz offered to structure the investment in the Pre-Need Company as a joint enterprise with Araneta. After some negotiation, Araneta agreed to participate in the deal ATR proposed.

> FN4. According to Araneta, "A pre-need company is like ... an insurance plan except that an insurance plan is something that you sell but you don't know when the event will happen. In the case of the pre-need, it's the same thing but a date is set." Tr. at 20. "In other words, you keep on paying monthly maybe for 20 years; and if anything happens to you within that 20-year period you can make a claim for your health or for your education." *Id.*

Based on this understanding, ATR and Araneta executed two contracts-an "Undertaking Agreement" [FN5] and a "Joint Venture Agreement" [FN6]-that set out the terms of their relationship and laid the groundwork for the Delaware Holding Company's incorporation. Through the Joint Venture Agreement, ATR and Araneta bought a controlling interest in the Pre-Need Company, and as part of this transaction, ATR advanced $3.922 million on Araneta's behalf (the "Advances").[FN7] In exchange for the Advances, Araneta pledged, in the Undertaking Agreement, to contribute the LBC Operating Companies along with

his newly acquired interest in the Pre-Need Company to a new holding company and to issue to ATR a 10% minority interest in that entity.[FN8]

FN5. PX 1.

FN6. PX 2.

FN7. The joint investment in the Pre-Need Company was made through one of ATR's subsidiaries, Professional Mutual Holdings, Inc. ("Professional Holdings") in which both Araneta and ATR had acquired 50% interests at a price of 37.5 million pesos (about $937,500) each. Using its 75 million pesos in contributed capital as well as an additional 239 million pesos nominally contributed on equal terms by ATR and Araneta (119.5 million pesos each), Professional Holdings purchased 80% of the Pre-Need Company. In this transaction, ATR advanced Araneta's portion as well as its own. As a result, Araneta owed ATR 157 million pesos (approximately $3.922 million).

FN8. The Undertaking Agreement specifically provided that Araneta would transfer the following assets to the Delaware Holding Company:
(i) LBC Domestic Franchise Co., Inc. and its subsidiaries; (ii) LBC Express, Inc. and its subsidiaries; (iii) LBC Mabuhay Development Philippine Corp. and its subsidiaries; (iv) LBC Holdings USA Corp. and its subsidiaries; (v) LBC International, Inc. and its subsidiaries (including all remittance businesses outside of LBC Holdings USA Corp.); (vi) LBC Development Bank; (vii) the foreign exchange business arising from the remittance transactions involving any and all of the above companies.
PX 1 at 2. For simplicity's sake, I refer to these as the LBC Operating Companies.

*4 To protect ATR's investment in the LBC Operating Companies, the Undertaking Agreement granted ATR contractual protections, including the right to a seat on the board of directors of any holding company that Araneta ultimately formed as well as a five-year put option, which, when exercised, required Araneta to buy out ATR's interest at the higher of (i) the issue price of ATR's shares plus a premium of between 22% and 25% per year, or (ii) the adjusted book value of ATR's shares.[FN9] Likewise, to safeguard their joint investment in the Pre-Need Company, ATR and Araneta executed a Stockholders Agreement which they attached to their Joint Venture Agreement (the "Stockholders Agreement").[FN10] The Stockholders Agreement evenly divided the eight (out of ten) board seats secured by ATR's and Araneta's joint 80% interest in the Pre-Need Company, and unanimously appointed Topax Colayco, the residual 20% shareholder in the Pre-Need Company, to be its President and CEO.

FN9. ATR also had an option to require Araneta to cede the shares the Advances had purchased as well as all rights and interests secured by the Advances if within a period of three months from the closing of the Joint Venture Agreement the LBC Operating Companies were not transferred into the holding company. Although it is undisputed that the holding company was not formed or funded within three months, ATR chose not to exercise this option.

FN10. DX 1 at Annex "A".

Although the Undertaking Agreement did not require that the holding company it contemplated be a Delaware, or even an American, entity, Araneta perceived the United States as a favorable jurisdiction in which to raise capital and viewed Delaware as a tax haven. In particular, Araneta viewed a Delaware entity as a vehicle that could be used to access the American capital markets through an initial public offering of stock. As a result, in January 2000, Araneta incorporated the Delaware Holding Company and presented ATR with 3,000 of its shares (10%) while personally retaining control over the residual 27,000 shares (90%). Likewise, Araneta appointed and dominated the Delaware Holding Company's board of directors, which consisted of himself, defendant Berenguer (Araneta's niece and the CFO of the LBC group of companies), and defendant Bonilla (the head

of LBC's U.S. operations).[FN11]

> FN11. Tr. at 109-15. I also note that ATR was not permitted to exercise its contractual right to appoint a director. By letter dated June 24, 2003, Arnaiz explained, "We were never provided regular, updated financials and a board seat ... in spite of our repeated request[s]." PX 51.

Thus, after 1999, ATR and Araneta were entwined in several ways: (1) they were contractually linked through the Undertaking Agreement, the Joint Venture Agreement, and the Shareholders Agreement; (2) they shared equal shareholder and directorial interests in the Pre-Need Company; (3) they possessed inverse majority and minority shareholder interests in the Delaware Holding Company; and perhaps most importantly, (4) Araneta and ATR were tied together through Araneta's friendship with Arnaiz.

B. *The Personal Nature Of This Dispute*

ATR's claims against Araneta boil down to an allegation that he abused his position of control over the Delaware Holding Company. Specifically, ATR claims that Araneta transferred the LBC Operating Companies from the Delaware Holding Company to his children for no consideration without notice to ATR and without following the process required by Delaware law.

Araneta does not dispute that the LBC Operating Companies are now owned by his family or that ATR has no interest in those assets through its minority ownership of the Delaware Holding Company. He merely claims never to have transferred ownership of the LBC Operating Companies to the Delaware Holding Company in the first place. He says that ATR knew that. What he never says is why ATR would have made a nearly $4 million payment to acquire 10% of an entity with no valuable assets. Further, in the event that I conclude that he is lying when he says that the Delaware Holding Company never owned the LBC Operating Companies, Araneta offers only the half-hearted and wholly-illogical defense that he was permitted to reclaim the LBC Operating Companies without payment through an accounting "offset" because he was the one who initially contributed the LBC Operating Companies to the Delaware Holding Company.

*5 To understand how a case as stark as this actually resulted in a trial, rather than a voluntary settlement by Araneta, it is useful to return to Araneta's relationship with his old friend, Ramon Arnaiz. That's right, this case is personal.

Araneta has known Arnaiz since they were five years old. As Araneta testified, he and Arnaiz were "very, very close friends, buddy buddies" who sat next to each other in classes and had parents who played mahjong together several times a week while they were growing up.[FN12] Although Araneta and Arnaiz went to different colleges, and ultimately into different careers, "whenever [they] saw each other [before this dispute], it was really a warm[ ] meeting ."[FN13]

> FN12. Tr. at 16.
>
> FN13. Tr. at 17.

But, as a result of their business dealings, Araneta's friendship with Arnaiz has ended. Araneta testified that he considers this case a "personal fight" between himself and Ramon Arnaiz.[FN14] He stated in his deposition and confirmed at trial that he did not think his co-directors had "anything to do with this tie-up with ATR."[FN15] And, perhaps most tellingly, he admitted on cross examination that at least "to some extent" this litigation was "over the disintegration of [his] friendship" with Arnaiz.[FN16]

> FN14. Tr. at 104.
>
> FN15. *Id.*
>
> FN16. *Id.*

That disintegration began in November 2002 when ATR sold its 50% interest in Professional Holdings, the corporation that owned 80% of the Pre-Need Company. Having closely aligned himself with Arnaiz and ATR, Araneta felt betrayed by that action. In compliance with the Shareholders Agreement, which secured ATR's right to sell its Professional Holdings shares as long as Araneta was given a right of first re-

fusal, ATR offered its shares to Araneta, but he refused to purchase them.[FN17] After Araneta declined, ATR sold its interest to Topax Colayco (the "Colayco Sale") giving Colayco co-equal control with Araneta over Professional Holdings and thus over Professional Holdings's 80% control bloc in the Pre-Need Company. But, because Colayco already directly owned the residual 20% of the Pre-Need Company that Professional Holdings did not, Araneta understandably viewed himself as having less leverage than Colayco in this dynamic.

FN17. *See* PX 44 (offering shares); Tr. at 59 (rejecting offer); *see also* DX 1 at Annex "A" § 5 (describing rights and restrictions regarding transfers of Professional Holdings shares).

Notwithstanding ATR's contractual right to sell its interest in Professional Holdings and Araneta's own failure to exercise his right of first refusal, Araneta felt victimized by Arnaiz and ATR and blamed them for subjugating him to the role of a minority investor under Colayco's de facto control. Even though Colayco had been a longstanding 20% shareholder in the Pre-Need Company, had managed its day-to-day operations as its President and CEO with Araneta's consent, and had served on the board of the Pre-Need Company with Araneta from the time Araneta first invested in the Pre-Need Company, Araneta testified that he felt as though he was "stuck running this company with a stranger." [FN18] Most important, he felt that ATR had done the sticking.[FN19]

FN18. Tr. at 86-90; DX 1 at Annex "A" § 3.03.

FN19. Araneta testified, "When [ATR] decided to get out of the business, I said 'My God, that's the very essence why I got involved in this business.... I don't understand the pre-need business.... The very person you're selling it to, I don't even know. I came to know him because of you.... How can you do this to me?" Tr. at 60-61.

Araneta allowed this hostility to affect his management of the Delaware Holding Company. After the Colayco Sale, Araneta withheld information, effectively closed the lines of communication with ATR, and eventually transferred all of the LBC Operating Companies out of the Delaware Holding Company.

C. The Discovery Of Araneta's Misconduct

*6 Araneta began to exact his revenge soon after the Colayco Sale was completed. In the months that followed, ATR repeatedly requested information on the condition of the Delaware Holding Company in which it still had nearly $4 million invested. But Araneta summarily rebuffed those requests. Araneta testified that any request ATR made for information during the entire 2003 calendar year went ignored because he was "no longer talking to them because [he was] upset with Mr. Arnaiz." [FN20] Throughout the first half of that year, lawyers in the Philippines exchanged letters regarding the "ongoing fight" between Araneta and Arnaiz, but were unable to resolve the matter. [FN21]

FN20. Tr. at 235.

FN21. Tr. at 233.

Fed up, ATR, through its attorneys, sent a formal books and records demand letter to Araneta on July 18, 2003.[FN22] In that letter, ATR exercised its right as a stockholder of a Delaware corporation to request financial statements of the Delaware Holding Company as well as documents showing the Delaware Holding Company's ownership of the LBC Operating Companies and Araneta's interest in the Pre-Need Company.[FN23] In hopes of a response, ATR sent additional demand letters to the Delaware Holding Company's corporate secretary at its registered address and to Araneta's attorney in the Philippines on the same day as it sent its letter to Araneta.[FN24] These additional demand letters sought to review the Delaware Holding Company's stock ledger, the records of all business transactions of the corporation, and the minutes of every meeting of the stockholders and directors of the Delaware Holding Corporation since its incorporation.[FN25]

FN22. PX 53 at 1-3. ATR copied Araneta's son, his lawyer, and the head of LBC's U.S. operations, defendant Bonilla, on this de-

mand. *Id.* at 3.

FN23. *Id.* at 4-9.

FN24. *Id.* (copying Araneta, his son, and Bonilla on each).

FN25. *Id.*

Each of ATR's demand letters warned that ATR would file suit to protect its interests if its demands were denied.[FN26] Yet, even knowing legal action was imminent, Araneta testified that he was "so angry with Mr. Arnaiz" that he "ignored these letters" and prevented ATR from gaining the information it sought.[FN27] Starved for information, ATR filed an action under 8 *Del. C.* § 220 in this court on October 27, 2003. But still irked by ATR's decision to sell its interest in Professional Holdings, Araneta "deliberately ignored" that lawsuit and instructed Bonilla not to provide the requested information. FN28

FN26. *See* PX 53 at 2 ("If we do not receive any response from you within ten (10) days ... we shall be constrained to initiate the appropriate legal actions ... to protect our client's interests."); *id.* at 5, 8 (providing similar warnings).

FN27. *Id.* at 238.

FN28. *Id.* at 239. Specifically, when discussing the § 220 litigation with Bonilla, Araneta told him, "Don't mind it." *Id.*

Only after being ordered by this court to turn over the records requested by ATR did Araneta do so. On January 14, 2004, Araneta produced a "Compliance" FN29 that purported to include all available documents but totaled only nine pages and failed to include many essential corporate papers.[FN30] The nine pages that Araneta did produce, however, included three documents that caused ATR great concern. Those documents-two balance sheets and a purported resolution of the board of directors-led ATR to believe that Araneta had conducted a de facto (and non-pro rata) liquidation of the Delaware Holding Company's assets and that Araneta was attempting to escape responsibility for that act.

FN29. PX 54.

FN30. In response to the pithy Compliance, ATR was permitted to depose Mr. Bonilla under 10 *Del. C.* § 368. That deposition uncovered several documents that had not been previously disclosed including the bylaws of the corporation, the corporate kit, and various financial and tax-related working papers. Finding that the corporation had not complied with its December 22 order, the court awarded ATR its attorneys' fees in prosecuting the § 220 action. Araneta's inappropriate behavior continued throughout the present litigation wherein he was repeatedly non-responsive, delayed the proceeding, and had to be admonished for exhibiting "close to contemptuous behavior" and having committed a "clear violation" of applicable rules by engaging in a "persistent pattern [of] flouting obligations that he owes under the rules of this Court and, frankly, under the Delaware General Corporation Law." *See* 4/20/04 Hearing Tr. at 10, 57, 59, 61, 67 (noting that "the horsing around, the inappropriate behavior, began long ago").

The two balance sheets that manifest the de facto liquidation are dated March 2003 and December 2003, respectively. Under Philippine accounting conventions, as adopted by the parties, both balance sheets reflect "investments" and "liabilities" in an unusual way. On the Delaware Holding Company's books, "investments" referred to the LBC Operating Companies and the Professional Holdings shares purchased for Araneta by ATR's Advances, which were to be owned by the Delaware Holding Company under the terms of the Undertaking Agreement. "Liabilities" represented the pro rata amounts due to Araneta and ATR as a result of the equity positions that each gained for their capital contributions. As of March, the Delaware Holding Company's balance sheet reflected approximately $36 million in "investments" and approximately $39 million in "liabilities." But, by December, the balance sheet showed only $937,500 in "investments" and $3.922

million in "liabilities." These financial statements indicated that during the last nine months of 2003 Araneta stripped the Delaware Holding Company of the LBC Operating Companies. The only operating asset he left in the Delaware Holding Company was ownership of the de facto minority position in the Pre-Need Company.

*7 A board of directors resolution Araneta produced in the Compliance is relevant to considering Araneta's intentions. In that document, dated May 22, 2003, Araneta putatively resigns his directorship along with Berenguer and Bonilla effective that day. In their stead, Araneta's secretary, Vicente, was supposedly appointed that day as the President and sole director of the Delaware Holding Company. As I discuss later, Vicente never assumed those positions and Araneta, Bonilla and Berenguer never left the Delaware Holding Company board. Araneta seems to have created this fiction in order to set up a phony defense to this court's jurisdiction and to claim that Vicente was responsible for any misfeasance at the Delaware Holding Company after May 22, 2003-a futile exercise in "plausible deniability."

D. *The Parties' Claims*

Based on the balance sheets unearthed in the § 220 action, ATR filed this lawsuit on June 3, 2004. ATR's complaint alleges direct and derivative injuries caused by the removal of the LBC Operating Companies, which were valued at nearly $36 million, from the Delaware Holding Company between March and December 2003. ATR claims that it was harmed as a stockholder of the Delaware Holding Company when Araneta effectively made a $36 million liquidation payment to his family without following the required process and without distributing to ATR its pro rata portion thereof. ATR also alleges that the corporation itself was injured by this transaction because it received no substantial consideration for the transfer of substantially all of its assets to the Araneta family.

In response, Araneta mounted three shifting defenses. First, he raised a "scapegoat" jurisdictional defense based on his purported resignation from the board of directors.[FN31] Further, in the event his jurisdictional argument proved unpersuasive, Araneta attempted to explain that contrary to his own contemporaneous admissions in e-mails, letters, and financial statements-and, yes, even tax filings-the LBC Operating Companies were never transferred into the Delaware Holding Company in the first instance because of tax issues.[FN32] Ultimately, in his deposition and at trial, perhaps recognizing the difficulties inherent in this "believe-me-now-I-was-lying-then" tax defense, Araneta proffered a half-hearted justification for the transfer of assets as an "offset" against the "liability" his family was owed for having contributed those assets.[FN33] If his implausible excuses were not expending ATR's and this court's limited resources and impeding ATR's just claim for recompense, Araneta's brazen and abundant falsehoods might be amusing. Because they have these costs, they are appalling.

FN31. Araneta raised this defense in his very first pleading, a Motion to Dismiss or Stay filed in July 6, 2004. Araneta also made this argument as his first affirmative defense in his Answer dated August 2, 2004.

FN32. This "tax defense" first appeared with along with the jurisdictional defense in Araneta's Motion to Dismiss or Stay. Over the two years since then, this argument gained prominence, becoming the focus of Araneta's pre-trial briefing.

FN33. *See* Tr. at 253-58 (referencing deposition testimony).

1. *Araneta's Scapegoat Defense*

In May 2003, Araneta claims that the composition of the board of directors of the Delaware Holding Company changed. Araneta asserts, based on a purported board resolution dated May 22, 2003 (the "May 2003 Resolution"), that he, Bonilla and Berenguer resigned as directors, and were replaced by one of his employees at LBC in the Philippines, Marites Vicente.

*8 Vicente is the assistant to the executive secretary to the chairman at LBC, which means that she reports directly to Araneta's secretary and ultimately to Araneta himself.[FN34] In this position, Vicente did the typing and filing for Araneta and his in-house at-

torneys, who included Ronaldo Tugonon, and sat at a desk just outside Araneta's office.[FN35] As part of her responsibilities, Vicente testified that she was regularly called upon to sign documents, many of which she did not understand, at the request of her bosses-Araneta and his attorneys.[FN36] For her work, Vicente earned a salary of 11,500 pesos (less than $300) per month. Valuing her job, Vicente never refused to perform the tasks her superiors asked her to perform, and in the three years she had worked for LBC, she never mustered the courage to ask Araneta for a raise even though she believed she deserved one.[FN37] In this light, Vicente admits that her signature appears on the Compliance, the May 2003 Resolution, and other corporate documents, but she denies that she understood those documents or ever knowingly became a director and officer of the Delaware Holding Company as Araneta has suggested.[FN38]

FN34. Vicente at 5-6.

FN35. Vicente at 4-5.

FN36. *See, e.g.*, Vicente at 43-45, 47, 50, 58.

FN37. Vicente at 3-4, 23-24.

FN38. *See, e.g.*, Vicente at 42-50, 57-58

Araneta's contention that Vicente was appointed as a director and officer of the Delaware Holding Company is likewise without support in the record. Neither the actions nor testimony of Araneta, Bonilla, Berenguer or Vicente are consistent with a complete overhaul of the board of directors of the Delaware Holding Company in May 2003. Vicente testified that she was never a director or officer of the Delaware Holding Company and that she was "surprised" to learn that she was listed as having those positions .[FN39] In fact, Vicente did not even know the name of the Delaware Holding Company and did not have any idea what the May 2003 Resolution was when it was shown to her.[FN40] Perhaps this should have been unsurprising because at his deposition, Araneta testified that he had appointed Vicente to those roles because "[s]he was there" and "[s]he looked timid." [FN41] Bonilla and Berenguer were likewise unaware of Vicente's appointment to the board. Berenguer testified that she did not learn of Vicente's apparent appointment until October or November of 2004. [FN42] Bonilla agreed that it was "news to [him] upon receiving [the Compliance containing the May 2003 Resolution while testifying] that [Vicente] was the president and director of the company." [FN43] Even Araneta did not acknowledge the role he purportedly assigned to Vicente-failing to name her as one of his co-directors at his deposition.[FN44]

FN39. Vicente at 56.

FN40. Vicente at 37-38, 46-47.

FN41. Araneta Dep. at 264.

FN42. Berenguer at 193.

FN43. Bonilla I at 85.

FN44. Tr. at 259-60.

The actions of Araneta, Bonilla, and Berenguer further manifested their ongoing service as directors after May 22, 2003. On May 23, 2003, the very day after he claims to have resigned, Araneta himself approved a board resolution-which he signed as a director!-to change the name of the Delaware Holding Company (the "Name Change").[FN45] Soon thereafter, Bonilla received a copy of the Name Change, and proceeded to prepare, sign, and file a certificate amending the Delaware Holding Company's charter on June 17, 2003, in accordance with the Name Change.[FN46] Moreover, in his mind, Bonilla continued to serve as a director of the Delaware Holding Company until December 2003. [FN47] Consistent with the notion that the leadership of the Delaware Holding Company remained unchanged until late 2003 or early 2004, Berenguer testified that she was still acting in her fiduciary capacity in January 2004. [FN48] Finally, even Araneta supported this notion when he stated that his co-directors at the time he prepared a balance sheet dated December 31, 2003 were Berenguer and Bonilla, but not Vicente.[FN49]

FN45. PX 54 at 7.

FN46. PX 54 at 6.

FN47. Bonilla I at 44-45.

FN48. *See* Berenguer at 139-45; Berenguer Ex. 2, at 21 (establishing that Berenguer signed a stock certificate as an officer of the Delaware Holding Company on January 9, 2004). I do note that Berenguer's testimony regarding her board service was a bit uncertain. She testified that she resigned from the boards of all companies except LBC Development and LBC Development Bank sometime during the period from April or May 2003 through December 2003. But, she was unable to be more specific about her resignation from the Delaware Holding Company's board than to agree that she believed she resigned "at some point after May 2003," and that she thought it might have been "[a]ny time from May ... to August." Berenguer at 82-83.

FN49. Tr. at 259-60.

*9 Thus, only the date on the May 2003 Resolution itself seems to indicate that a transition of the board of directors occurred at the Delaware Holding Company on May 22, 2003. Yet, even this resolution is suspect. At trial, ATR presented evidence that the substance, format, and notary stamps used in preparing this resolution were consistent with it being created in January 2004-at the same time as the Compliance-rather than in May 2003-a day before the Name Change.[FN50] Specifically, the Name Change refers to the Delaware Holding Company as "LBC Global Corporation," uses a type-written fill-in-the-blank format, and bears a notary stamp from Ronaldo Tugonon in a bolded, sans-serif font.[FN51] Meanwhile, both the certification of share ownership submitted in the Compliance and dated January 9, 2004 (the "Certification") and the May 2003 Resolution employ a fully-completed word-processed format, refer to the Delaware Holding Company as "PMHI Holdings Corporation (formerly LBC Global Corporation)," and carry a faded notary stamp from Tugonon in a serif typeface.[FN52] Perhaps most striking is that when confronted with these documents Araneta did not vehemently deny a charge of fabrication; instead, he claimed a convenient lack of memory.[FN53]

FN50. In his post-trial briefing, Araneta submitted the affidavit of Ronaldo Tugonon, the LBC in-house attorney who notarized each of the documents in question, which asserts that Tugonon maintained two offices and two notary stamps, and that his notary logs support the contemporaneous notarization of the May 2003 Resolution, rather than it being back-dated. Def. Post-Trial Br. Ex. 3. I do not consider this post-trial affidavit or its exhibits because it was submitted after the close of evidence at a time when ATR was unable to cross-examine Tugonon or test the merits of his affidavit. *See Stigliano v. Anchor Packing Co.*, 2006 WL 3026168, *1 (Del.Super.Ct.2006) (concluding that a post-deposition affidavit was hearsay and "not sufficiently trustworthy to allow its admission" when it had not been "tested by cross-examination"). I further note that the two-cities-two-stamps position Tugonon advances is hardly unassailable given that the "PTR" lines at the end of each notary stamp list the city of Pasay. *See* PX 59. Moreover, Tugonon's credibility is also suspect because he was likely involved, at the very least, in having Vicente sign documents in a capacity to which she was never properly appointed, which she did not understand, and which she never knowingly assumed.

FN51. PX 59.

FN52. *Id.*

FN53. Tr. at 142.

The timing of the May 2003 Resolution and the date of its appearance in this case also support ATR's claim of fabrication because this chronology establishes a motive for the creation of such a document. The May 2003 Resolution first appeared in the January 2004 Compliance-nearly six months after ATR's July 2003 demand letters put Araneta on notice of impending litigation and nearly three months after the § 220 action was filed-at a time when Araneta must

have realized that this court would not permit him to ignore ATR's demands. Moreover, when the May 2003 Resolution was produced in the Compliance, it was accompanied by balance sheets indicating that the removal of the LBC Operating Companies occurred between May 31, 2003 and December 31, 2003-after Araneta's purported resignation.[FN54] On that basis, Araneta asserted jurisdictional defenses and attempted to shift responsibility to Vicente.

FN54. *See* PX 54.

In light of all the evidence presented, it is possible that the May 2003 Resolution is a back-dated fabrication. Regardless, it is clear that none of the actual Delaware Holding Company directors stood behind it. Each continued to act as a Delaware Holding Company officer and director after that date. As important, it is undisputed that Vicente never accepted appointment to the Delaware Holding Company board and was not properly appointed at any board meeting, by any stockholder vote, or by any other recognized corporate procedure.[FN55] As such, I find the board of the Delaware Holding Company at all relevant times consisted of Araneta, Bonilla, and Berenguer. Consequently, I hold that as a factual matter Vicente was never a director of the Delaware Holding Company.

FN55. *See* Berenguer at 200-01 (confirming that the Delaware Holding Company did not have board meetings after January 2001, when its incorporation and funding were completed, and that there was never a formal meeting of the stockholders of the Delaware Holding Company at any time).

2. *Araneta's Tax Defense*

***10** Araneta's assertion that the Delaware Holding Company was never fully funded or operational is also one I reject as false. Araneta states that he never transferred the LBC Operating Companies to the Delaware Holding Company and that certain post-registration requirements necessary to commence business operations were never completed. As such, he contends that the plan to create and utilize the Delaware Holding Company to implement the Undertaking Agreement was abandoned in May 2000 as a result of certain adverse tax consequences of that proposal. But, these tax issues were resolved by December 2000-before the Delaware Holding Company was incorporated, before Araneta confirmed the Delaware Holding Company's ownership of the LBC Operating Companies, and before Araneta caused the Delaware Holding Company to file tax returns containing that same information.

Araneta bases his tax argument on the receipt of an opinion letter from a tax specialist that identified material tax obligations that would arise if the LBC Operating Companies were transferred into the Delaware Holding Company. That letter dated May 10, 2000 expressed the opinion that:
The proposal to make [LBC], a Philippine corporation, into a subsidiary of [the Delaware Holding Company] (a U.S. corporation) by an exchange of shares raises a number of concerns ... [because] corporations formed in the U.S. are taxed by the U.S. on their worldwide income, generally at a 34% or 35% rate on income above $100,000, though with limited crediting of the foreign tax they pay on foreign income.... On the other hand, the U.S. generally has no tax claim on the profits of non-US subsidiaries of non-US corporations.[FN56]

FN56. DX 21 at 4. Araneta also testified that he was informed that the initial transfer of assets into Delaware would create a tax liability in excess of $7.4 million. Tr. at 35 ("[T]here was a big mistake in incorporating-in putting assets in Delaware because of a very exorbitant or huge tax problem that my family or LBC was going to absorb. At some point, the amount ... was, in the tune of 7.4 to $8 million, rough estimates.").

As a result of these adverse tax consequences, Araneta testified that the Delaware Holding Company was abandoned as the implementation device and his focus shifted towards creating a holding company in Hong Kong.[FN57]

FN57. Tr. at 222.

ATR contends that any tax issue Araneta had with the

use of the Delaware Holding Company in the months surrounding May 2000 was resolved before the end of that year. Manuel Tordesillas, ATR's chief executive officer and one of the parties who signed the Undertaking Agreement, testified that he was not made aware of any tax issues that prevented the transfer of assets to the Delaware Holding Company until the start of this litigation.[FN58] Further, because the Undertaking Agreement placed the responsibility on Araneta and LBC to organize and fund the Delaware Holding Company, Tordesillas explained that ATR was not involved in these implementation issues.[FN59]

FN58. Tr. at 289.

FN59. Tr. at 299-300, 383. This is unsurprising because the primary funding for the Delaware Holding Company was the transfer of assets controlled by Araneta, not ATR.

Moreover, by December 2000, ATR solicited and obtained Araneta's confirmation that he had incorporated and funded the Delaware Holding Company as part of ATR's negotiation of the sale of its 10% interest in the Delaware Holding Company to Philtread Tire & Rubber Company ("Philtread"). In connection with this sale, ATR informed Araneta of the need to complete the transactions required by the Undertaking Agreement. On December 8, 2000, Arnaiz emailed Araneta saying, "[T]o date, LBC is not in compliance with our agreement that requires LBC to set up a holding company incorporating under it all its subsidiaries." [FN60] That same day, Araneta responded:

FN60. PX 7 at 2.

*11 PLEASE BE INFORMED THAT WE HAVE ALREADY INCORPORATED THE HOLDING COMPANY FOR YOUR ENTRY AS PER OUR PREVIOUS AGREEMENTS ..... WE HAVE ALSO RESOLVED WITH OUR TAX CONSULTANTS THE MANNER OF THE TRANSFER OF SOME ASSETS TO THE HOLDING CO[.], WE SHOULD WITHIN A WEEK OR TWO BE ABLE TO ISSUE IN THE NAME OF ATR [ITS] TEN PERCENT OWNERSHIP AND TOGETHER WITH IT THE STOCK CERTIFICATE CORRESPONDING TO THE TEN PERCENT.[FN61]

FN61. PX 7 at 1 (capitals and ellipses in original).

Three days later, on December 11, 2000, Araneta reiterated:

THE HOLDING COMPANY THAT WILL OWN THE "ARANETA" INTERESTS IN 100% LBC HOLDINGS USA, 100% LBC DEVELOPMENT AND 50% OF PROFESSIONAL MUTUAL HOLDINGS INC. IS LBC GLOBAL.... WE [ARE] REQUIRING LBC HOLDINGS USA AND LBC DEVELOPMENT TO ISSUE THE NECESSARY CERTIFICATES IN FAVOR OF LBC GLOBAL CORPORATION.[FN62]

FN62. PX 8 at 1.

These emails are devastating to Araneta's claims that tax problems forced the abandonment of the Delaware Holding Company in early-to-mid 2000 and that as a result of those alleged tax problems, no assets were ever transferred to the Delaware Holding Company. Rather than demonstrate a continuing reluctance or refusal to transfer assets, the emails indicate that by December 11, 2000, any tax problems relating to the transfer of the LBC Operating Companies to the Delaware Holding Company had been resolved such that Araneta was issuing the necessary certificates to effect this transfer.[FN63]

FN63. *See* PX 7, 8.

In addition to his December 2000 emails, Araneta personally confirmed that the Delaware Holding Company owned the LBC Operating Companies on two separate occasions in 2001. On January 22, 2001, Araneta signed a deed of adherence letter (the "Deed of Adherence") in both his personal capacity and as chairman of LBC Development attesting to the transfer of the LBC Operating Companies to the Delaware Holding Company.[FN64] Six months later, on July 26, 2001, Araneta executed, in his personal capacity and on behalf of the Delaware Holding Company, a confirmation letter (the "Confirmation Letter") clari-

fying the Deed of Adherence and providing a balance sheet indicating that assets were owned by the Delaware Holding Company as of March 31, 2001.FN65

FN64. PX 20.

FN65. PX 27.

The Deed of Adherence explicitly confirmed the formation and funding of the Delaware Holding Company. It verified that:

[T]he holding company referred to as LBC HoldCo [the Delaware Holding Company] in the Undertaking Agreement has now been duly incorporated under the laws of the State of Delaware, U.S.A. and is named "LBC Global Corporation" which now owns, directly or indirectly, the Professional Holdings Shares, the Professional Holdings Advances, all the shares and interest in LBC and all the shares and interests in the companies and businesses which are owned and controlled by [Araneta], as follows:

(i) LBC Domestic Franchise Co., Inc. and its subsidiaries;

(ii) LBC Express, Inc. and its subsidiaries;

(iii) LBC Mabuhay Development Philippine Corporation and its subsidiaries;

(iv) LBC Holdings USA Corp. and its subsidiaries;

*12 (v) LBC International, Inc. and its subsidiaries (including all remittance businesses outside of LBC Holdings USA Corporation);

(vi) LBC Development Bank;

(vii) the foreign exchange business arising from the remittance transactions involving any and all of the above companies.FN66

FN66. PX 20 at 1-2.

Likewise, the Deed of Adherence included Araneta's consent to ATR's transfer of its interest in the Delaware Holding Company to Philtread and ATR's affiliation with Philtread going forward.

The drafting history of the Deed of Adherence reinforces Araneta's contemporaneous representations. Araneta originally agreed to provide the Deed of Adherence in the Undertaking Agreement, and confirmed that intention on January 9, 2001 in an email to ATR.FN67 He received an initial draft of the Deed of Adherence on January 10, 2001, and an electronic version the following day.FN68 Araneta and his attorneys revised the Deed of Adherence and sent it back to ATR for comments.FN69 ATR further revised the document to provide for ownership "directly or indirectly" of the assets by the Delaware Holding Company and to clarify language allowing the transfer of the assets to a Hong Kong entity only "provided, that all the assets ... shall *remain* owned and held by a single holding company, and that ATR shall in any event own and hold 10% of the capital stock of the same holding company."FN70 Neither Araneta nor his attorneys amended or renounced the claim that the LBC Operating Companies had, in fact, been transferred to the Delaware Holding Company, and Araneta executed the final version of the Deed of Adherence guaranteeing ATR's right to 10% of those assets.

FN67. Tr. at 170-71.

FN68. PX 15.

FN69. PX 18.

FN70. PX 19 at 1-2 (emphasis added).

The Confirmation Letter signed six months later reaffirmed the formation of the Delaware Holding Company and its ownership of the assets in both its text and in the balance sheet it incorporated as an attachment. The Confirmation Letter clearly stated:

As contemplated in the Undertaking Agreement and the [Deed of Adherence], LBC Global Corporation [i.e., the Delaware Holding Company] ... now owns directly or indirectly, the Professional Holdings Shares, the Professional Holdings Advances, all the shares and interest in LBC Development Corporation and the companies and businesses listed in the Undertaking Agreement which are owned and controlled by Mr. Carlos R. Araneta.FN71

FN71. PX 27 at 1.

Likewise, the balance sheet dated March 31, 2001 that was attached to the Confirmation Letter illustrated the Delaware Holding Company's recognition

of both its ownership of the LBC Operating Companies as assets and its pro rata liabilities to the Araneta family and ATR as described in the text of the letter.FN72 On the balance sheet, LBC Holdings USA, LBC Development, and Araneta's Professional Holdings shares are all listed under assets as "Investments" having a value of $36,235,500 at cost.FN73 Likewise, the balance sheet shows "Liabilities" of $39,220,000, represented as $3,922,000 "due to" ATR as well as a $35,298,000 "accounts payable" entry for the Araneta family.FN74 These "Liabilities" correspond exactly to the relative ownership of the Delaware Holding Company-10% to ATR and the remaining 90% to Araneta.

FN72. The Confirmation Letter explained the unique accounting methods used for the contribution of the assets. ATR and Araneta's contributions, although infusions of cash generating equity ownership interests, were recognized as liabilities due to the shareholders under a Philippine accounting practice. The Confirmation Letter clarified that the liabilities reflected on the balance sheet as a result of this transaction were payable pro rata based on percentage share ownership, much like dividends would be paid on equity. Specifically, the Confirmation Letter explained that "[a]ny conversion of all or any portion of the liabilities into equity shall be effected by LBC Global pro rata in proportion to the outstanding amount owed to each of the holders thereof," and "[a]ny full or partial payment or prepayment by LBC Global of the liabilities shall be made to all holders thereof pro rata in proportion to the amount owed to them respectively." PX 27 at 1-2.

FN73. *Id.* at Annex "A."

FN74. *Id.*

*13 In addition to Araneta's representations of the Delaware Holding Company's ownership of the assets, disclosures and financial statements by others affiliated with the Delaware Holding Company confirm that the corporation held controlling interests in the LBC Operating Companies from 2001 through 2003. Berenguer created a balance sheet identical to the one discussed above on July 19, 2001 in preparation for its inclusion in the Confirmation Letter.FN75 Victor Marquez, the Delaware Holding Company's accountant, distributed another copy of that very same balance sheet in the corporation's financial statements dated March 2001 and March 2002 FN76 and proffered it under the pains and penalties of perjury to the State of Delaware and the federal government as part of the corporation's tax returns filed for 2001 and 2002.FN77 In fact, no financial statement prepared between the balance sheet incorporated in the July 2001 Confirmation Letter-which Berenguer testified to have double checked before submitting FN78-and the balance sheet dated May 31, 2003 prepared by Araneta and submitted in connection with his Compliance in the § 220 action that preceded this dispute ever showed any combination of assets, liabilities, and equity inconsistent with the Delaware Holding Company's ownership of the LBC Operating Companies.

FN75. PX 23. Berenguer also testified to the Delaware Holding Company's ownership of the LBC Operating Companies on at least seven different occasions during her testimony. *See* Berenguer at 88-89, 155, 174, 177, 186, 201, 281.

FN76. *See* PX 25; PX 47.

FN77. *See* PX 41; PX 50.

FN78. Berenger testified that she was "double careful" in reviewing the figures on the balance sheet, and that she "cross-checked them against the letter" before she or Araneta signed off on them. Berenguer at 153-55.

On the basis of this contemporaneous record and as a predicate to my ultimate decision in this case, I conclude that the Delaware Holding Company owned the LBC Operating Companies. Correspondingly, I find that Araneta's testimony to the contrary was self-serving and untruthful.

3. *Araneta's Offset Defense*

Araneta's final defense is a semantic attempt to disguise the unfairness of his removal of the LBC Operating Companies. To explain the differences in the March 2003 and December 2003 balance sheets, Araneta testified that he had "offset" the roughly $36 million in assets he had removed from the Delaware Holding Company, i.e., the LBC Operating Companies, against the liability the Delaware Holding Company showed as "payable" to his family in the same amount. FN79 He maintains that the Delaware Holding Company is better off as a result of this transaction because of this decrease in its liabilities. FN80 But, Araneta still claims control over 90% of the equity in the Delaware Holding Company and never indicated that the assets had been transferred to any other holding company in which ATR would have a minority interest. FN81

FN79. When asked whether he had "offset the LBC assets-LBC Holdings and LBC Development-which added up to roughly 36 million ... against the Araneta advance liability that equaled the same 36 million," Araneta answered, "Yes. I think so, yes." Tr. at 253-54. Moreover, Araneta agreed that he "didn't consult with anyone when [he] did that." *Id.* at 254.

FN80. *Id.*

FN81. *Id.*

This "offset" defense does not withstand even minimal scrutiny. Despite the nomenclature on the financial statements, which characterize the contributions of the Advances and the LBC Operating Companies as "liabilities" rather than "equity," there is no dispute that the LBC Operating Companies were contributed in exchange for Araneta's 90% equity interest. Moreover, the Deed of Adherence and Confirmation Letter explain that any distributions out of the Delaware Holding Company would be paid pro rata on the majority and minority equity investments. No pro rata payment was made to ATR, and Araneta did not forfeit his equity position in the Delaware Holding Company when he cashed out the assets that he initially contributed. Thus, this scenario is even further removed than a non-pro rata exchange accompanying the retirement of the majority equity stake, which would liquidate one investor's stake and leave the remaining investor in complete control of the remaining assets. Here, the majority investor claims not to have given up his equity position even though it withdrew the entirety of its investment.

*14 It is illogical that ATR would be in a better position owning 10% of what had essentially become a shell corporation than it had been in while indirectly owning a share of the LBC Operating Companies. After the removal of the LBC Operating Companies, ATR's interest in the Delaware Holding Company was essentially a 10% stake in Araneta's minority position in the Pre-Need Company. FN82 If such a result were permitted to stand, it would unjustly enrich Araneta because after removing the same assets that he initially contributed he would have gained an indirect interest in the Pre-Need Company for nothing. That result is untenable, especially because ATR paid the costs of acquiring the Pre-Need Company out of its coffers in 1999. Thus, no legitimate offset could have taken place.

FN82. Tr. at 256-58.

Factually, then, Araneta's "offset" argument is without basis. Unlike some scenarios in which there may be a dispute as to the values given or received, this is a straightforward self-dealing case in which Araneta took something for nothing. His secretive conduct reinforces this point. FN83 Thus, I find the factual predicate for Araneta's "offset" argument has not been satisfied.

FN83. Araneta admitted that he alone decided to carry out this transaction without consulting with anyone, without notifying the other directors, and without informing ATR. Tr. at 254, 260.

E. *The Philippine Litigation Front*

After ATR filed its § 220 action in Delaware and was met with Araneta's first instance of litigation abuse, it was sued by Araneta in the Philippines. In that action, Araneta sought, among other relief, the annulment of

the Undertaking Agreement and Joint Venture Agreements on the grounds that ATR fraudulently concealed the implications, risks and consequences involved in the acquisition of the Pre-Need Company.FN84 In response, ATR sought a declaration of validity and judicial approval of the Colayco Sale.

FN84. Def. Post-Trial Br. Ex. 1 at 1. Jurisdiction for this contractual dispute was established in the Philippines based on forum selection clauses in both the Joint Venture Agreement and Undertaking Agreement providing: "Each of the parties irrevocably consents to the exclusive jurisdiction of the courts of the National Capital Judicial Region with respect to any action or proceeding relating to this Agreement." PX 1 at 5; DX 1 at 8.

In the end, Araneta lost his case in the Philippines decisively. The Regional Trial Court refused to annul any of the contracts between the parties. FN85 In upholding the validity of the Joint Venture Agreement and the Undertaking Agreement, the Regional Trial Court found that "there was no incident present in the case that would destroy the freedom of Araneta to enter in the agreements" and described Araneta's grounds for annulment to be "sham and contrived." FN86 It dismissed Araneta's complaint and entered judgment for ATR on January 24, 2006.

FN85. Def. Post-Trial Br. Ex. 1 at 4.

FN86. *Id.* at 3-4.

Following that decision, Araneta moved for reconsideration and ATR moved to enforce its rights under § 5 of the Undertaking Agreement, which granted ATR a put option whereby ATR could require Araneta to purchase its interest in the Delaware Holding Company. After reviewing the claims, on May 8, 2006, the Regional Trial Court reaffirmed the validity of the Undertaking Agreement and amended its previous decision to include the implementation of the provisions of § 5 of the Undertaking Agreement.FN87 As such, the court found Araneta "liable for the aggregate subscription or issue price of the [Delaware Holding Company] shares and the premium of 25% per annum." FN88 Araneta, of course, appealed that judgment. The parties indicate that the appellate process in the Philippines could take many years to complete.

FN87. Def. Post-Trial Br. Ex. 2 at 2.

FN88. *Id.* at 3.

III. *Legal Analysis*

*15 With this backdrop in mind, I begin my analysis with Araneta's suggestion that this court is not the proper forum for ATR's claims. I next turn to Araneta's disloyal conduct and false disclosures while serving as the dominant director and controlling stockholder of the Delaware Holding Company. Then, I focus on the other directors-Bonilla and Berenguer-and take up the questions regarding their responsibility to monitor Araneta's conduct. Finally, I address the appropriate relief to be awarded, including whether to grant ATR's request for an award of imposition of attorneys' fees and costs.

A. *Delaware Is The Proper Forum For ATR's Claims*

Araneta contends that the entirety of his dispute with ATR should have been resolved in the Philippines under the terms of the forum selection clauses of the Joint Venture Agreement and the Undertaking Agreement. But, in this court, ATR has premised its claims entirely on the fiduciary duties Araneta, Berenguer, and Bonilla owed to it as directors of a Delaware corporation, not on any other contractual duties that may exist between the parties. As such, this court may properly decide ATR's Delaware law claims.

Under the teaching of *Parfi Holding AB v. Mirror Image Internet, Inc.*, FN89 ATR was not required to press its Delaware law claims in the Philippines, as they do not "depend on the existence" of the Undertaking Agreement or Joint Venture Agreement for their viability.FN90 When sued by Araneta in the Philippines, ATR had no practical choice but to invoke its contractual remedies as defenses. By doing so, ATR did not waive claims it had against Araneta that are grounded in other legal and equitable duties Araneta owed to it that were not contractual in

nature.

FN89. 817 A.2d 149 (Del.2002).

FN90. *See id.* at 155-57 (explaining that "fiduciary duties ... consist of a set of rights and obligations that are independent of any contract" and can only be limited in their assertion by contractual provisions when "the claims based on fiduciary duties touch on the obligations created in the [contract]").

Here, ATR simply seeks to finish the process it began in July 2003, before Araneta filed his action in the Philippines, when it first began to pursue Araneta for breaching his duties as the director of a Delaware corporation. The existence of the Philippine litigation provides Araneta no defense. If he wished to escape this court's jurisdiction in responding to claims against him as a Delaware director, he needed to secure an explicit right to that effect. He did not do so and this court is available to ATR for it to seek redress as a stockholder of a Delaware corporation. Because ATR's claims alleging breaches of fiduciary duty by Araneta-as well as his co-directors Bonilla and Berenguer-arise independently of the parties' contracts, ATR does not seek an impermissible double recovery.

B. *Araneta Breached His Duty Of Loyalty By Stripping The Delaware Holding Company Of Its Major Assets For No Consideration*

ATR's allegations against Araneta are clear-cut claims of self-dealing by a controlling shareholder and director of a Delaware corporation. Araneta does not contest that he was the controlling shareholder of the Delaware Holding Company, and I have already found that his factual argument that he was not a director at all relevant times is without merit. Similarly, I have found as a fact that Araneta removed from the Delaware Holding Company its primary assets-its ownership of the LBC Operating Companies. In its financial statements and tax filings, the Delaware Holding Company had valued this ownership interest at over $36 million.[FN91] Yet, by the end of 2003, this value had disappeared from the Delaware Holding Company's books. To where did Araneta remove the assets? To his family. What did the Delaware Holding Company receive in exchange? Effectively nothing. Araneta did not even reduce his 90% interest in the Delaware Holding Company when he repossessed the very assets that had secured that interest in the first place. Araneta simply took the LBC Operating Companies back in a fit of pique.

FN91. *See* Tr. at 254.

*16 The standard of review to evaluate this self-dealing is, of course, the entire fairness standard.[FN92] As a director, Araneta had a duty of loyalty to the Delaware Holding Company to act in the best interests of the corporation and its shareholders and in a manner such that there would be "no conflict between [his] duty and [his] self-interest."[FN93] Thus, as the director who conceived of and carried out the transfer of the LBC Operating Companies from the Delaware Holding Company to members of his family for no value, Araneta bore the burden of establishing the fairness of this transaction.[FN94]

FN92. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del.1983) ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.").

FN93. *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del.1939).

FN94. *See Chaffin v. GNI Group, Inc.*, 1999 WL 721569, at *5 (Del. Ch.1999) (finding that a father "must be deemed 'interested' in a transaction from which his child stood to benefit substantially in career and economic terms" and that "the entire fairness standard would apply").

Likewise, as the majority stockholder of the Delaware Holding Company, Araneta owed fiduciary duties to the minority shareholders of the corporation when dealing with the corporation's property.[FN95] In this role, Araneta was prohibited from using his position of control to extract value from the corporation to the exclusion of, and detriment to, the minority stockholders.[FN96] Consequently, in this capacity as

well, the law imposed upon Araneta the obligation to prove that the transfer he structured using his total dominion over the Delaware Holding Company's affairs was fair to the minority rather than an extraction of value to their detriment.[FN97] Araneta did not do that.[FN98]

FN95. *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 109-10 (Del.1952).

FN96. *See* *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del.1971).

FN97. *See* *id.* at 721 (explaining that where a parent corporation "would be receiving something from [its] subsidiary to the exclusion of and detrimental to [the subsidiary's] minority stockholders" the combination of that "self-dealing, coupled with the parent's fiduciary duty, would make intrinsic fairness the proper standard").

FN98. This fraudulent transfer also involved a sale of substantially all of the Delaware Holding Company's assets and had to be performed consistently with 8 *Del. C.* § 271, which sets forth the procedures required to complete such a transaction. ATR has asserted, without contradiction from Araneta, that these procedures were not followed, and specifically that no shareholder vote took place. For his part, Araneta testified that he did not even inform ATR or his fellow directors about his removal of the LBC Operating Companies. Tr. at 254-55.

In this case, Araneta has not disputed these principles or even advanced an argument under the entire fairness rubric. Indeed, quite obviously, what Araneta did was not fair to the Delaware Holding Company or its minority stockholder, ATR. Araneta's only major defense is his factual claim that the assets were never transferred into the Delaware Holding Company. On this basis, Araneta asserts, without citation to any legal authority, that entire fairness review cannot attach to his transfer of the LBC Operating Companies. That is, Araneta rests his entire case on a factual claim which I reject.[FN99]

FN99. Because I reject the factual underpinning of Araneta's argument, I need not decide the legal issue he presents. But, I doubt that Delaware law would permit a fiduciary who contracted to convey assets to a corporation when soliciting a minority shareholder's investment and who later confirmed the corporation's ownership of those assets while serving as a director of that corporation to escape liability for redirecting those assets away from the corporation merely because the fiduciary "cut out the middleman" and never honored his obligation to place the assets into the corporation's accounts in the first place. Fiduciary duties do not attach only when assets are transferred but rather arise "where one person reposes special confidence in another, or where a special duty exists on the part of one person to protect the interests of another, or where there is a reposing of faith, confidence, and trust, and the placing of reliance by one person on the judgment and advice of another." *Lank v. Steiner*, 213 A.2d 848, 852 (Del. Ch.1965), *aff'd*, 224 A.2d 242 (Del.1966). From the moment Araneta became a director of, and ATR became a stockholder of, the Delaware Holding Company, Araneta had an obligation to enforce the Delaware Holding Company's right to ownership of the LBC Operating Companies for the benefit of the corporation and its shareholders that paralleled but existed independently from his contractual duty to cause the same transfer to occur. *See* *Legatski v. Bethany Forest Assoc., Inc.*, 2006 WL 1229689, at *6 (Del.Super.Ct.2006) (recognizing that contractual and fiduciary duties are not mutually exclusive).

That factual claim is ridiculous. Araneta asserts that for tax reasons he never did what he and his allies said he had done in numerous documents-including the corporation's tax filings!-that is, transfer control of the LBC Operating Companies to the Delaware Holding Company. Araneta says he was pondering using a Hong Kong company instead. But a written

agreement with ATR indicates that if Araneta wished to transfer the LBC Operating Companies to a Hong Kong entity, it could only do so on specific contractual terms. No evidence of such a transfer exists. Most important of all, it is preposterous to believe that ATR was willing to allow Araneta to keep the LBC Operating Companies for himself, rather than transferring them into some other corporation, whether located in the Philippines, Hong Kong, or elsewhere, in which ATR would have a 10% interest.

Recognizing that this claim might well be found ludicrous, Araneta and his counsel propounded an equally unpersuasive defense. They try to claim that the LBC Operating Companies were transferred to Araneta's family to extinguish a $36 million debt owed to the Aranetas by the Delaware Holding Company. On cross-examination, Araneta opined that the Delaware Holding Company was better off following the transaction because he "offset" these assets against a "liability" that the corporation owed to his family.[FN100]

FN100. Tr. at 256-57.

*17 Nothing in the record supports this position. The liability that Araneta purported to offset arose as a result of his contribution of the LBC Operating Companies and was valued based on Araneta's 90% ownership stake. But, following his so-called offset, Araneta testified that he maintained his 90% ownership.[FN101] Thus, ATR was left with a 10% stake in what is now effectively a shell corporation devoid of its primary operating assets, while Araneta and his family gained a windfall by retaining a 90% interest in the Delaware Holding Company's remaining assets-primarily the minority interest in the Pre-Need Company-without giving any substantial value in exchange. Suffice it to say that Araneta could not point to any fairness-enforcing procedures that he used to come up with this blatantly unfair transaction. Rather plainly, any director, officer, or advisor acting in good faith would have protested that the transaction was fraudulent.

FN101. Tr. at 258.

The evidence in this case is clear, and Araneta's attempts to distort that reality only make his conduct less tolerable. Araneta used his majority control and effective dominion over the Delaware Holding Company and its board of directors to engage in a course of unfair dealing that resulted in a de facto liquidation of corporate assets that enriched the Araneta family at the expense of the Delaware Holding Company and ATR.

C. If The Delaware Holding Company Never Owned The LBC Operating Companies, Araneta Breached His Duty Of Loyalty By Knowingly Disclosing False Information

In order to dispute his self-interested transfer of the LBC Operating Companies, Araneta testified that the Deed of Adherence and Confirmation Letter he signed and sent to ATR while he was a director of the Delaware Holding Company were false. These documents confirmed, both in express representations of fact and through financial statements showing the corporation's assets, that the Delaware Holding Company owned the LBC Operating Companies. But, Araneta testified at trial that he and ATR knew the ownership representations to be false at the time he signed the documents containing them. As I have explained, I find this "believe-me-now-I-was-lying-then" defense to be without merit. Yet, even if I were to accept the factual predicate to Araneta's argument, it would not aid Araneta in escaping liability.

As a corporate fiduciary, Araneta was required to be candid in all of his communications concerning the Delaware Holding Company's financial condition. As our Supreme Court explained in *Malone v. Brincat*, the fiduciary duty of loyalty prohibits a director from lying to the stockholders.[FN102] Thus, "[i]t necessarily follows from *Malone* that when directors communicate with stockholders, they must recognize their duty of loyalty to do so with honesty and fairness."[FN103] As such, a stockholder may carry its burden by establishing that a director breached his or her "fiduciary duty of loyalty ... by knowingly disseminating to the stockholders false information about the financial condition of the company."[FN104]

FN102. 722 A.2d 5, 12 (Del.1998).

FN103. *Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 390 (Del. Ch.1999).

FN104. *Malone*, 722 A.2d at 10.

*18 ATR has met its burden here. If Araneta's testimony in court is to be believed, he himself admits that his statements in the Deed of Adherence and in the Confirmation Letter were lies. Araneta testified: "The truth is, I signed these documents. And when I signed these documents they were not true. I signed these documents, but the assets were not transferred to Delaware." FN105 Moreover, Araneta confirmed that he understood that he was signing the Confirmation Letter "at the request of ATR for [the] Filipino Stock Exchange" and that he knew public shareholders would be seeing this information in some form.FN106 Thus, in Araneta's own words, neither the representations in the Deed of Adherence, the Confirmation Letter, nor the financial statements attached thereto provided an accurate picture of the Delaware Holding Company, and he knew it.

FN105. Tr. at 206-07.

FN106. Tr. at 200.

Araneta's defense to these admissions-that ATR should have known the falsity of the statements-is without merit. According to Araneta's tale, told for the first time at trial, Arnaiz pressured him to sign these documents and he gave in to that pressure to support his friend and to curry favor with the Philippine government because the brother of the Philippine President was involved with ATR.FN107 Although in Araneta's story ATR requested the letters, that fact does not establish that ATR knew the information therein to be untrue. Only Araneta's claim that he told Arnaiz that those statements were false purports to do that.FN108 Based on the ever-shifting positions taken by Araneta throughout this litigation, the conflict between his testimony on the witness stand and the contemporaneous emails he sent in December 2000, and the lack of any records indicating ATR's knowledge that the assets were not owned by the Delaware Holding Company after Araneta stated that the tax issues had been resolved, I do not credit Araneta's testimony.

FN107. Tr. at 42-47.

FN108. Araneta also argues that various communications sent to ATR regarding the purported tax and other hurdles to making the Delaware Holding Company operational between November 1999 and April 2000 provided notice to ATR that the assets had not been transferred to the Delaware Holding Company. *See* DX 5-21. But, the timing of these communications undercuts their value. Following these communications, Araneta sent an e-mail in December 2000 expressly stating that "WE HAVE ALSO RESOLVED WITH OUR TAX CONSULTANTS THE MANNER OF THE TRANSFER OF SOME ASSETS TO THE HOLDING CO." PX 7 at 1 (capitals in original). The only communication on this topic that Araneta sent after this date, an e-mail dated January 3, 2001, does not list anyone at ATR as a recipient. DX 22.

Consequently, I find that even if Araneta did not transfer the LBC Operating Companies to the Delaware Holding Company, he still violated his fiduciary duties to ATR on an alternate basis. Specifically, I hold that if the LBC Operating Companies were never owned by the Delaware Holding Company, Araneta breached his duty of loyalty to ATR by knowingly disclosing false information concerning the Delaware Holding Company, including false financial statements indicating its ownership of the LBC Operating Companies.FN109

FN109. Moreover, as a director of the Delaware Holding Company, Araneta had a duty to seek recourse against himself-odd, but true-if he failed to deliver the stock of the LBC Operating Companies to the Delaware Holding Company. Of course, I find that his breach occurred later, when he stripped the Delaware Holding Company of those Companies' stock. But either way, Araneta breached his fiduciary duties.

ATR has also brought a fraud claim against Araneta. Given that this claim is identical to ATR's *Malone*

claim but would arguably involve more stringent standards,[FN110] and because I have already found that the transfer occurred and was substantially unfair, I need not reach it. Insofar as reasonable reliance is required, ATR has shown that after being informed that the Delaware Holding Company owned the LBC Operating Companies, it acted on that information.

> FN110. Delaware's standards of fiduciary disclosure are specialized applications of fraud standards. As a result, a plaintiff is rarely better off pressing garden-variety common law fraud claims when a more tailored fiduciary disclosure claim can be pursued. *See Metro Communication Corp. BVI v. Advanced Mobilecomm Technologies Inc.*, 854 A.2d 121, 156 (Del.Ch.2004) ("[T]he standards that a fiduciary faces are tougher than the common law and equitable fraud standards, which always require proof of reasonable reliance.").

In a transaction that closed in November 2001, ATR sold its 10% interest in the Delaware Holding Company to Philtread, reinvesting the entire proceeds of the sale as well as roughly $1.2 million in additional capital back into Philtread to create an Internet service and fulfillment business. ATR intended to use the LBC Operating Companies as part of the fulfillment side of its business model for Philtread. More importantly, because Philtread was publicly listed on the Philippine Stock Exchange, ATR made representations to the Philippine equivalent of the U.S. Securities and Exchange Commission and to outside investors that the Delaware Holding Company was "the ultimate holding company for all the LBC operations," including the LBC Operating Companies, among others, based on Araneta's express confirmation of those facts in the Deed of Adherence and Confirmation Letter he signed while a director of the Delaware Holding Company.[FN111] As such, to the extent that ATR cannot hold Araneta accountable by receiving a remedy for his actions in never giving up ownership of the LBC Operating Companies, ATR has exposed itself to liability by endorsing and disseminating Araneta's false statements.

> FN111. PX 32 at 33 (describing the Delaware Holding Company in Philtread's public disclosures); *see also* PX 20 (Deed of Adherence); PX 27 (Confirmation Letter) (containing Araneta's express representations).

*19 Of course, I ultimately conclude that Araneta did originally hand over the LBC Operating Companies to the Delaware Holding Company and that the Delaware Holding Company did own those assets for over two years-from at least January 22, 2001, when Araneta attested to that fact in the Deed of Adherence, to May 31, 2003, the date of the last balance sheet showing ownership of those assets-before Araneta stripped them away for no value. But, either way, Araneta has caused harm to ATR.

D. *Bonilla And Berenguer Acted As Stooges For Araneta And Failed To Take Any Steps To Perform Their Duties As Fiduciaries*

I now come to a slightly more difficult issue. Namely, to what extent should Araneta's fellow directors, Bonilla and Berenguer, share responsibility for harming the Delaware Holding Company and ATR?

Making this more challenging is that ATR does not allege that either Berenguer or Bonilla participated in, approved of, or directly profited from Araneta's removal of the LBC Operating Companies. Rather, ATR claims that Bonilla and Berenguer consciously breached the important duties articulated in this court's *Caremark* [FN112] decision and recently reaffirmed by our Supreme Court in *Stone v. Ritter*.[FN113] Specifically, ATR alleges that Bonilla and Berenguer failed to monitor Araneta's conduct thereby allowing his self-dealing to continue.

> FN112. *In re Caremark Int'l. Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch.1996).
>
> FN113. 911 A.2d 362, 2006 WL 3169168 (Del.2006).

Under Delaware law, it is fundamental that a director cannot act loyally towards the corporation unless she tries-i.e., makes a genuine, good faith effort-to do her job as a director.[FN114] One cannot accept the im-

portant role of director in a Delaware corporation and thereafter consciously avoid any attempt to carry out one's duties.

FN114. *See* *Guttman v. Huang*, 823 A.2d 492, 506 & n. 34 (Del. Ch.2003).

One of the most important duties of a corporate director is to monitor the potential that others within the organization will violate their duties. Thus, "a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists." FN115 Obviously, such a reporting system will not remove the possibility of illegal or improper acts, but it is the directors' charge to "exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary questions, so that it may satisfy its responsibility." FN116 Thus, as the Supreme Court recently stated:

FN115. *Caremark*, 698 A.2d at 970.

FN116. *Id.*

Caremark articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.FN117

FN117. *Stone*, 911 A.2d 362, 2006 WL 3169168, at *17.

***20** From the testimony of the directors of the Delaware Holding Company, it is apparent that no reporting system was in place and that no other information systems or controls were ever considered, let alone implemented, by the Delaware Holding Company's board of directors. They did not even have regular board meetings. As a result, the directors were often unaware of corporate activities-despite how easy that would have been given the Delaware Holding Company's modest size. Berenguer testified that although there had been meetings regarding the Delaware Holding Company before the LBC Operating Companies were transferred into the corporation in January 2001, she did not remember any meetings of the board of directors or of the shareholders after that time.FN118 Bonilla confirmed this fact, explaining that when the Delaware Holding Company's name was changed from LBC Global, Corp. to PMHI Holdings, Corp., he was never informed about the change, never voted to approve it, and did not even know what the initials PMHI in the new corporate name stood for at the time he signed the certificate of amendment as the corporation's authorized agent.FN119 Even when corporate activities involved them directly-as in the case of their supposed resignations from the board of directors-neither Berenguer nor Bonilla questioned the wisdom of Araneta's actions nor insisted that corporate procedures be followed. FN120

FN118. Berenguer at 201.

FN119. Bonilla I at 175-76; *see also* PX 54 at 6-7.

FN120. Notwithstanding the issues regarding the date of their resignation as directors, the process by which Berenguer and Bonilla were removed by Araneta is telling. Bonilla testified that he received a phone call from Araneta informing them that he was no longer a director of the Delaware Holding Company. Bonilla I at 47. Berenguer explained that she did not give formal written notice of her resignation; instead, Araneta just "took it [she] wanted to resign" from the Delaware Holding Company based on her general "verbal intention" to "resign in all LBC" and eventually "replaced" her. Berenguer at 83-84, 195.

Moreover, both Berenguer and Bonilla testified that they entirely deferred to Araneta in matters relating to the Delaware Holding Company. Berenguer is, as mentioned, Araneta's niece and served as the CFO for the LBC group of companies worldwide.[FN121] She testified that she would not insert herself into a disagreement between ATR and Araneta about how the Delaware Holding Company should proceed on an issue because such a disagreement would be between those parties and would not affect her as a director of the Delaware Holding Company.[FN122] Similarly, she stated that she would take Araneta's word as authoritative if he claimed that he had agreed with ATR to take certain actions.[FN123] Bonilla, the head of Araneta's U.S. operations, was more explicit-explaining that to him Araneta and the Delaware Holding Company were basically one and the same and that he took the word of Araneta as being the word of the company.[FN124] Moreover, when pressed regarding whether he would undertake an independent inquiry if told to act by Araneta, Bonilla responded, "Why should I ask him all these questions? He's telling me they have already agreed .... It's not like I'm going to go out there and check on him, doesn't make sense."[FN125]

FN121. Berenguer at 47-48.

FN122. Berenguer at 68.

FN123. Berenguer at 197.

FN124. Bonilla I at 63.

FN125. Bonilla I at 180-81.

Based on these failures, neither Berenguer nor Bonilla can be said to have upheld their fiduciary obligations. Although it was Araneta who ran amok by emptying the Delaware Holding Company of its major assets, the other directors did nothing to make themselves aware of this blatant misconduct or to stop it.

*21 Put in plain terms, it is no safe harbor to claim that one was a paid stooge for a controlling stockholder. Berenguer and Bonilla voluntarily assumed the fiduciary roles of directors of the Delaware Holding Company. For them to say that they never bothered to check whether the Delaware Holding Company retained its primary assets and never took any steps to recover the LBC Operating Companies once they realized that those assets were gone is not a defense. To the contrary, it is a confession that they consciously abandoned any attempt to perform their duties independently and impartially, as they were required to do by law. Their behavior was not the product of a lapse in attention or judgment; it was the product of a willingness to serve the needs of their employer, Araneta, even when that meant intentionally abandoning the important obligations they had taken on to the Delaware Holding Company and its minority stockholder, ATR.

When required by their office to be loyal to the Delaware Holding Company, Bonilla and Berenguer chose total fealty to Araneta's conflicting interests instead. Consequently, I find them jointly liable for Araneta's fiduciary violations.

E. *The Core Remedy*

The major breach of fiduciary duty in this case is one that injured the Delaware Holding Company in the first instance and ATR secondarily as a minority stockholder. The obvious remedy for this wrongdoing would be to require Araneta to return control of the LBC Operating Companies to the Delaware Holding Company.

ATR is practical, however. It recognizes that it would likely take years and years to chase Araneta and his family around the nation (Araneta has a house in California) and across the globe to get that type of order implemented. Thus, ATR is willing to forsake a full remedy (in the sense that it appears the LBC Operating Companies have done very well) and to accept a direct award of damages.

A direct award to ATR is justified here. Araneta's behavior worked a de facto liquidation of the Delaware Holding Company. It would be unreal to require a monetary award to the Delaware Holding Company by Araneta and his blindly subservient subordinates, Bonilla and Berenguer. Even if such a payment were made, it would be foolhardy to believe that Araneta and his servants could be trusted to allow ATR to be-

nefit from the grant of that relief to the Delaware Holding Company.

Rather, because Araneta's conduct had the effect of liquidating the Delaware Holding Company, it is appropriate to premise relief on the need to make ATR whole for the injury it suffered by entrusting its capital to the Delaware Holding Company, only to see that corporation impoverished by the defendants. The best way to shape that award is to require Araneta and the defendants to pay back to ATR the cost of acquiring its equity in the Delaware Holding Company-$3.922 million-plus pre-judgment interest at a rate that fairly compensates ATR for its loss of the upside inherent in the LBC Operating Companies' profit and growth. In determining that rate, I am aided by the parties' dealings and Araneta's admittedly high cost of debt and equity capital. Araneta's cost of debt was as high as 18%.[FN126] This high (equity-level) rate supports the fairness of a very high rate of interest, as it suggests an even higher cost of equity. That conclusion is confirmed by § 5 of the Undertaking Agreement. In that section, ATR secured a put option at a premium of 25% per annum over the issue price of ATR's shares in the Delaware Holding Company if exercised after the first two years of the investment. Using this contractual estimate of Araneta's cost of equity is the best way to do justice, even though it likely still leaves Araneta with a windfall.[FN127] I will compound this interest rate monthly in accordance with my understanding of prevailing commercial practices and in order to better ensure that ATR is made whole.[FN128]

FN126. *See* Bonilla II at 44-45 (confirming that LBC's cost of private debt is 15%-18%).

FN127. *See* *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 175 (Del.2002) (permitting the Court of Chancery to fashion "broad, discretionary, and equitable remedies" in cases involving a breach of the duty of loyalty); *Int'l Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437, 440 (Del.2000) ("[T]he powers of the Court of Chancery are very broad in fashioning equitable and monetary relief under the entire fairness standard as may be appropriate."); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 715 (Del.1983) (holding that when the entire fairness standard is not met, the Court of Chancery's "powers are complete to fashion any form of equitable and monetary relief as may be appropriate"). In fashioning a remedy, I err on the side of generosity to the plaintiffs because "Delaware law dictates that the scope of recovery for a breach of the duty of loyalty is not to be determined narrowly" and because "strict imposition of penalties under Delaware law are designed to discourage disloyalty." *Bomarko*, 766 A.2d at 441 (quoting *Thorpe by Castleman v. CERBCO, Inc.*, 676 A.2d 436, 445 (Del.1996)); *see also* *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 855 A.2d 1059, n. 20 (Del. Ch.2003).

FN128. *See* *Brandin v. Gottlieb*, 2000 WL 1005954, at *29 (Del. Ch.2000) (explaining that this court has "broad discretion, subject to principles of fairness, in fixing the rate [of interest] to be applied"); *Gotham Partners*, 817 A.2d at 173 (finding that the Court of Chancery's "uncontested 'discretion to select a rate of interest higher than the statutory rate ... include[s] the lesser authority to award compounding.' "); *see also* *Henke v. Trilithic, Inc.*, 2005 WL 2899677, at *13 (Del. Ch.2005) (explaining that awarding interest compounded on a monthly basis because doing so better "comports with the fundamental economic reality" that investors and "companies neither borrow nor lend at simple interest rates"); *Smith v. Nu-West Indus.*, 2001 WL 50206, at *1 (Del. Ch.2001) (awarding interest compounded monthly), *aff'd*, 781 A.2d 695 (Del.2001).

*22 It is worth noting that ATR requested monthly compounding in their opening brief. The defendants did not respond to this request except insofar as they argued that no damage award of any amount should be entered. Suffice it to say, the defendants are therefore in no position to quibble about the interest rate I now award, having forsaken their chance to respond.

All of the defendants will be jointly and severally liable for the amount of the judgment. Nonetheless, I find that in any action as between Araneta, on the one hand, and Bonilla and Berenguer, on the other, Araneta should be deemed responsible to pay the entire judgment. In other words, to the extent it is later important, if Bonilla and Berenguer pay any or all of the judgment, Araneta should be required to make them whole, to the extent that is consistent with applicable law.FN129

FN129. In qualifying this statement, I simply recognize that when persons act as mere tools for malefactors and contribute to harm to others, public policy might limit their ability to seek indemnification from their "boss," so to speak. That might be an occupational hazard.

F. *Attorneys' Fees*

Finally, I consider ATR's request for an award of attorneys' fees. Delaware follows the American Rule under which parties to litigation normally bear their own costs regardless of the outcome of their case.FN130 Yet, the American Rule, and correspondingly Delaware's application thereof, provide for fee awards in exceptional circumstances in order to deter abusive litigation, avoid harassment, and protect the integrity of the judicial process.FN131 These circumstances include fraud, bad faith, or other outrageous conduct from which the claim arose and bad faith behavior in the course of subsequent litigation.FN132 Here, ATR claims that the egregious nature of Araneta's fiduciary breaches coupled with the implausibility of his defenses and his bad faith in defending this litigation necessitate a fee-shifting award. I agree.

FN130. *Johnston v. Arbitrium (Cayman Islands) Handels*, 720 A.2d 542, 545-46 (Del.1998); *see also* John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 AM. U.L. REV. 1567 (1993) (contrasting the American Rule with the English Rule whereby the losing party must pay the victor's litigation expenses).

FN131. *Kaung v. Cole National Corp.*, 884 A.2d 500, 506 (Del.2005).

FN132. *See Gans v. MDR Liquidating Corp.*, 1998 WL 294006, at *3 (Del. Ch.1998) ("Delaware courts have recognized the following as meriting an award of fees: (i) statutory authority; (ii) a class representative's litigation costs on behalf of the class; (iii) bad faith conduct in litigation; and (iv) fraud, bad faith, or other outrageous conduct from which the claim arose.").

The U.S. Supreme Court has explained that "bad faith may be found, not only in the actions that led to the lawsuit, but also in the conduct of the litigation."FN133 Delaware courts have awarded attorneys' fees when defendants "had no valid defense and knew it," when "they unnecessarily required the institution of litigation, delayed the litigation, asserted frivolous motions, falsified evidence and changed their testimony to suit their needs," and when, in short, they "constructed their entire defense in bad faith."FN134 Although any one of these findings alone would be sufficient to justify a shifting of fees; in this case, there is ample evidence to establish transgressions in each of these categories by Araneta.

FN133. *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 766 (1980) (citations and quotations omitted).

FN134. *Arbitrium (Cayman Islands) Handels*, 702 A.2d at 546; *see also Jacobson v. Dryson Acceptance Corp.*, 2002 WL 31521109, at *16 (Del. Ch.2002) (stating that fee awards "may be appropriate where a party misleads the court, alters his testimony or changes his position."), *aff'd*, 826 A.2d 298 (Del.2003).

Here, Araneta's bad faith was pervasive. Araneta's basic duties as a fiduciary of the Delaware Holding Company were well-established. But, by transferring the LBC Operating Companies from the Delaware Holding Company to his family for no value, Araneta flouted his obligations to the minority shareholders and profited at their expense. Moreover, when served

with the § 220 suit, this lawsuit, and confronted with his conduct, Araneta engaged in a deliberate pattern of obfuscation ranging from the obstruction of legitimate discovery requests, to the presentation of baseless and shifting defenses, and ultimately to the telling of outright lies under oath and the submission of a phony defense in an attempt to escape this court's jurisdiction by exposing his own secretary to legal risk on the pretense that she was the sole director of the Delaware Holding Company during the period when Araneta denuded it of the LBC Operating Companies.FN135

FN135. *See H & H Brand Farms, Inc. v. Simpler*, 1994 WL 374308, at *5-6 (Del. Ch. June 10, 1994) (imposing fee award for "acts of bad faith and wanton disregard for the rights of others").

*23 Certainly, not all breaches of the fiduciary duty of loyalty warrant the imposition of attorneys' fees.FN136 But, where an "untenable conflict should have been perfectly obvious," a director's "effrontery in going forward nonetheless is reprehensible" and those "seeking to censor this outrageous conduct should have their attorneys' fees paid." FN137 Thus, as an initial matter, I may award fees if I find that Araneta's conduct giving rise to this litigation constituted "an egregious breach" of his duty to ATR. FN138 His conduct involved such an egregious breach. It was a fraudulent transfer that Araneta sought, by later fraud, to conceal.

FN136. *See, e.g., Weinberger v. UOP, Inc.*, 517 A.2d 653, 656 (Del. Ch.1986) (refusing to award fees for breach of fiduciary duty absent unjustifiable or bad faith conduct).

FN137. *Gans*, 1998 WL 294006, at *4.

FN138. *Id.*

Likewise, Araneta's misconduct during the litigation process was extensive. He obstructed legitimate requests for discovery. He proffered false testimony in order to avoid this court's jurisdiction and liability. In sum, he made the procession of the case unduly complicated and expensive.

Chancellor Allen well captured the traditional reluctance of this court to shift fees under the bad faith exception to the American Rule, by stating that the bad faith exception only applied when the party in question displayed "unusually deplorable behavior." FN139 Even under that standard, which is more stringent than that articulated recently by our Supreme Court in *Kaung v. Cole National Corp.*,FN140 Araneta easily qualifies for an order requiring him to pay ATR's attorneys' fees and expenses. Because of Araneta's bad faith, I also will enter an order requiring him to bear any additional attorneys' fees and expenses ATR is forced to bear in seeking to collect on this judgment. This will ensure that ATR obtains full relief if it is forced to expend even more resources to obtain redress from Araneta.

FN139. *Barrows v. Bowen*, 1994 WL 514868, at *2 (Del. Ch.1994).

FN140. 884 A.2d 500, 506 (Del.2005).

On this score, however, Bonilla and Berenguer are in a different position than Araneta. Their regrettable, if all too historically traditional, role as instruments of a controller's will rightly exposes them to damages liability, but they have not engaged in conduct that satisfies the exacting bad faith standard required for fee shifting.

IV. *Conclusion*

Based on the foregoing, I find in favor of ATR on each of its claims and award ATR $3,922,000 in damages plus pre-judgment as well as post-judgment interest on this amount. Pre-judgment interest shall accrue at an annual rate of 25% with monthly compounding from the date of ATR's investment in the Delaware Holding Company through the date a final judgment is entered. Post-judgment interest at the statutory rate will accrue thereafter until payment is made. Araneta shall also pay ATR's attorneys' fees, costs, and expenses incurred in prosecuting this action and shall pay any future costs expended by ATR in enforcing this judgment. Counsel for the parties shall craft a final order implementing this decision within 20 days.

Del.Ch.,2006.

ATR-Kim Eng Financial Corp. v. Araneta
Not Reported in A.2d, 2006 WL 3783520 (Del.Ch.)

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E-Filed: 7/23/07

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re HUGO N. BONILLA, Debtor.	Case No. 07-30309 Chapter 7 Case
ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, v. HUGO NERY BONILLA, Defendant.	Adv. Proc. No. _____ STATUS CONFERENCE Date: September 7, 2007 Time: 11:00 a.m. Place: 235 Pine Street Courtroom 23 San Francisco, California Judge: Hon. Thomas E. Carlson

COMPLAINT (1) TO DETERMINE THAT DEBTOR HUGO BONILLA IS NOT ENTITLED TO A DISCHARGE IN BANKRUPTCY PURSUANT TO 11 U.S.C. §727(A) AND (2) SEEKING DETERMINATION OF NON-DISCHARGEABILITY OF DEBT PURSUANT TO 11 U.S.C. §523(A)(4)

EXHIBIT B

Plaintiffs and Creditors ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc., for their claims against Hugo Nery Bonilla, the debtor in the above-captioned Chapter 7 case, allege as follows:

JURISDICTION AND VENUE

1. This is an adversary proceeding (the "Adversary Proceeding") to: (a) deny the Debtor's discharge under 11 U.S.C. §727(a) or, in the alternative, (b) determine the dischargeability of the Debtor's debt to Plaintiffs ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc., under 11 U.S.C. §523(a)(4).

2. This Court has jurisdiction over this Adversary Proceeding by virtue of 28 U.S.C. Sections 157 and 1334 and Bankruptcy Rules 4004, 4007, 7001(4) and 7001(6).

3. This Adversary Proceeding is a core proceeding under 28 U.S.C. Sections 157(b)(2)(I) and (J), and this Court may enter a final judgment pursuant to 28 U.S.C. Section 157(b).

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN

4. Venue is proper in this Court under 28 U.S.C. Sections 1408 and 1409, as this Adversary Proceeding arises under and in connection with a Chapter 7 bankruptcy case styled *In re Hugo Nery Bonilla*, No. 07-30309 (Northern District of California, San Francisco Division, filed March 16, 2007), which is pending before this Court.

PARTIES

5. Plaintiffs and Creditors ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. (hereinafter collectively, "ATR") are investment and financial services corporations headquartered in the Philippines.

6. Defendant and Debtor Hugo Nery Bonilla ("Bonilla") is an individual, residing in the State of California.

7. ATR is a judgment creditor of Bonilla, having obtained a money judgment for over $24.5 million against Bonilla and others in a case entitled *ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. v. Carlos R. Araneta, Hugo Bonilla, et al.*, Delaware Court of Chancery No. CIV. A. 489-A (judgment entered January 10, 2007).

8. Bonilla filed a voluntary petition in this Court (the "Petition") under Chapter 7 of

the United States Bankruptcy Code on March 16, 2007 (the "Petition Date").

FACTUAL BACKGROUND

A. BONILLA'S BREACH OF FIDUCIARY DUTIES TO ATR AND THE RESULTING DELAWARE JUDGMENT.

9. Many of the factual findings pertinent to this Complaint are set forth in an opinion issued by the Delaware Court of Chancery on December 21, 2006 (hereinafter, the "Memorandum Opinion"). A copy of the Memorandum Opinion is attached as Exhibit A to this Complaint and incorporated by reference herein. Unless otherwise stated, ATR alleges paragraphs 10 through 23 below on information and belief based upon the Memorandum Opinion and documents filed in connection with that case.

10. Bonilla is the President of LBC Holdings USA Corporation and various related United States companies. These companies are part of a larger family of "LBC" companies, some based in the United States and others in the Philippines. The LBC companies—both domestic and worldwide—are principally involved in courier and remittance services to the Philippines.

11. The founder of the LBC family of companies is a Philippine businessman by the name of Carlos R. Araneta (hereinafter "Araneta"). As found by the Delaware Court of Chancery, "Araneta exercises de facto and clear control over his family's worldwide holdings." Memorandum Opinion (Ex. A) at *3 n.3.

12. In 1999, Araneta entered into a series of business dealings with ATR. These business dealings culminated in ATR advancing money to Araneta in exchange for receiving a ten percent interest in PMHI Holdings Corp. (the "Delaware Holding Company"), a newly formed holding company that was eventually incorporated in the State of Delaware.

13. The Delaware Holding Company's chief assets consisted of certain LBC companies that Araneta agreed to transfer into the Delaware Holding Company. At the time of the transfer, these LBC entities had a stated value of $35 million, although their value has increased substantially since then.

14. Araneta retained personal control over the Delaware Holding Company and

appointed its board of directors. The three-person board consisted of Araneta, Liza Berenguer (who is Araneta's niece and a former chief financial officer within the LBC family of companies), and Bonilla.

15. At all times relevant to this action, Bonilla served as a director of the Delaware Holding Company. As a corporate director, Bonilla owed fiduciary duties to ATR under Delaware law including, among other things, the duty to protect the value of the Delaware Holding Company's assets, and, thereby, the value of ATR's interest in the Delaware Holding Company. Specifically, and as expressly found by the Chancery Court in the Memorandum Opinion, Bonilla had duties:

- "to monitor the potential that others within the organization would violate their [own] duties" (Memorandum Opinion (Ex. A) at *19);
- "to attempt in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists" (*id.* (internal quotations marks and footnote omitted)); and
- to "exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary questions, so that it may satisfy its responsibility" (*id.* (internal quotations marks and footnote omitted)).

16. Beginning in November 2002, ATR and Araneta had a falling out related to ATR's decision to withdraw from certain business relationships with Araneta. This withdrawal, although permissible under the terms of the parties' agreements, angered Araneta, who shortly thereafter began taking steps to injure ATR.

17. Sometime between May and December 2003, Araneta conducted, as the Delaware Chancery Court expressly found, a *de facto* liquidation of the corporate assets of the Delaware Holding Company. He transferred its only valuable assets—the LBC entities—to members of his own family without consideration to the Delaware Holding Companies , and without informing ATR of the transfers, or causing the Delaware Holding

Company to make a distribution to ATR on account of these transfers. As a result, ATR was left with a 10 percent interest in a company that was effectively a shell corporation stripped of its primary assets.

18. Bonilla, who was at all relevant times a director of the Delaware Holding Company, failed to monitor Araneta's conduct, protect ATR's interests, or stop Araneta from liquidating the corporate assets of the Delaware Holding Company for no consideration.

19. Throughout the first half of 2003, ATR's attorneys sent demand letters to Araneta, and his agents, seeking to examine the books and records of the Delaware Holding Company. Upon information and belief, certain of these demand letters were copied to Bonilla. Araneta ignored these letters and instructed Bonilla to ignore them as well.

20. ATR was therefore forced to enlist the assistance of the Delaware courts to compel Araneta and the Delaware Holding Company to turn over corporate documents. ATR filed an action in the Delaware Court of Chancery pursuant to Section 220 of the Delaware Corporations Code to require production of the books and records of the Delaware Holding Company. Only after a court order was issued in this action did Araneta and the Delaware Holding Company finally turn over at least some documents responsive to the request. These records, though sparse, revealed that during the last nine months of 2003 Araneta had stripped the Delaware Holding Company of its interest in the LBC companies, its principal assets.

21. ATR filed a liability and damages suit in June 2004 against Araneta and his two co-directors, Berenguer and Bonilla. *See ATR-Kim Eng Financial Corp., et al. v. Carlos R. Araneta, Hugo Bonilla, et al., C.A. No. 489-N (Del. Ch. 2006).* With respect to Berenguer and Bonilla, ATR alleged that they had breached their fiduciary duties to ATR, a minority shareholder in the Delaware Holding Company, by failing to monitor Araneta or prevent his fraudulent conduct.

22. The case proceeded to trial in the Delaware Court of Chancery in August 2006. The Vice Chancellor issued a 54-page Memorandum Opinion on December 21, 2006.

23. In the Memorandum Opinion, the Court found all three defendants—Araneta, Berenguer and Bonilla—jointly and severally liable for the damages caused to ATR. With respect to Bonilla, the Court found that he (along with his co-director, Berenguer) had breached fiduciary duties to ATR by, among other things:

- "allow[ing] Araneta to do whatever he wanted, without any examination of whether his conduct benefited the Delaware Holding Company and all of its stockholders, rather than simply Araneta personally" (Memorandum Opinion (Ex. A) at *1);
- treating "Araneta and the Delaware Holding Company [as] basically one and the same and [taking] the word of Araneta as being the word of the company" (*id.* at *20);
- never "question[ing] the wisdom of Araneta's actions nor insist[ing] that corporate procedures be followed" (*id.* *20);
- "consciously abandon[ing] any attempt to perform [his] duties independently and impartially, as [he was] required to do by law" (*id.* at *21);
- evincing a "willingness to serve the needs of [his] employer, Araneta, even when that meant intentionally abandoning the important obligations they had taken on to the Delaware Holding Company and its minority stockholder, ATR" (*id.*); and
- "act[ing] as—no other word captures it so accurately—[a] stooge[] for Araneta, seeking to please him and only him, and having no regard for [his] obligations to act loyally towards the corporation and all of its stockholders" (*id.* at *1).

24. The Court issued its Final Order Of Judgment (the "Delaware Judgment") on January 10, 2007. A copy of the Delaware Judgment, as recorded on January 11, 2007, is attached hereto as Exhibit B to this Complaint and incorporated by reference herein. In that Judgment, the Court held that all three defendants were jointly and severally liable to ATR "in the amount of $24,490,422.50" (Ex. B at 1 (emphasis in original)), plus post-judgment interest accruing at a rate of 11.25 percent per year.

25. The Final Judgment was affirmed on appeal by the Delaware Supreme Court in a two-page summary decision entered on June 14, 2007, in which the Court concluded that:

"the final judgment of the Court of Chancery should be affirmed on the basis of and for the reasons assigned by the Court of Chancery in its decision dated December 21, 2006 [the Memorandum Opinion]. [¶] NOW, THEREFORE, IT IS HEREBY ORDERED that the final judgment of the Court of Chancery, entered on January 10, 2007, is, AFFIRMED." A copy of the Delaware Supreme Court's decision is attached to this Complaint as Exhibit C and incorporated by reference herein.

26. The amount of interest accruing from the date of the Delaware Judgment to the date of Petition is $490,647.16.

27. Thus, as of the date of the Petition, Bonilla was indebted to ATR for a judgment debt in the amount of $24,981,069.66 ("the Judgment Debt").[1]

B. BONILLA ENGAGED IN THREE SEPARATE TRANSFERS OF HIS PROPERTY WITH ACTUAL INTENT TO HINDER DELAY OR DEFRAUD HIS CREDITORS, INCLUDING ATR, WITHIN ONE YEAR OF THE PETITION DATE.

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28. Upon information and belief, Bonilla engaged in three transfers of his property with actual intent to hinder, delay or defraud ATR in its collection efforts within one year of the Petition Date.

29. The first such transfer involved a multi-million dollar home located at 1605 Wedgewood Drive, Hillsborough, California (the "Hillsborough Property"). As of May 2005, Bonilla was the sole record owner of the Hillsborough Property. On January 8, 2007, however, three weeks after the Memorandum Opinion was issued and two days before the Final Judgment was entered, Bonilla signed a Grant Deed transferring the Hillsborough Property to Monica Araneta—Carlos Araneta's daughter—for "consideration of less than $100." A copy of that Grant Deed is attached hereto as Exhibit D.

30. Upon information and belief, the transfer occurred at the office of Carlos Araneta's attorney, with Carlos Araneta present. Monica Araneta herself was not present.

[1]Since the filing of the Petition, ATR has recovered $11,566.60—a mere fraction of the Judgment Debt—from Araneta by way of bank levies and writs of execution.

31. Upon information and belief, in transferring the Hillsborough Property to Monica Araneta, Bonilla acted with the intent to hinder, delay or defraud ATR in its efforts to collect on the Delaware judgment.

32. Upon information and belief, the transfer of the Hillsborough Property was not for adequate consideration and was made without any forewarning or notice to ATR, Bonilla's principal creditor.

33. Upon information and belief, Bonilla transferred the Hillsborough Property to an "insider"—*i.e.*, the daughter of a co-defendant.

34. Upon information and belief, at the time of the transfer of the Hillsborough Property, Bonilla had incurred or reasonably believed that he would incur a debt to ATR beyond his ability to pay.

35. The second and third transfers of real property involved parcels of property located in Newark, California. As of September 2006, Bonilla was the sole owner of real property located at 37022 Locust Street, Newark, California (the "Locust Street Property"). Also, at the time of the Delaware action, Bonilla and his wife co-owned real property located at 36611 Sequoia Court, Newark, California (the "Sequoia Court Property"), which was, and remains, their residence.

36. According to documents recorded with the San Mateo County (California) Recorder's Office, on January 18, 2007, just a week after entry of the Delaware Judgment, Bonilla signed grant deeds transferring both the Locust Street and the Sequoia Court Properties to his aunt, Dora Maritza Aberouette ("Aberouette"). These grant deeds were recorded with the Alameda County Recorder's Office on January 25, 2007 and January 29, 2007, respectively.

37. Upon information and belief, the transfers of the Locust Street and Sequoia Court Properties were private sales to Aberouette, not arm's-length transactions, and Bonilla never solicited or entertained bids from other potentially interested parties.

38. Upon information and belief, although Aberouette paid consideration in exchange for the transfer of the Locust Street and Sequoia Court Properties, that consideration did not

reflect the amount of payment that could have been received following an arm's-length sale on the open market.

39. Upon information and belief, in transferring the Locust Street and Sequoia Court Properties to Aberouette, Bonilla acted with the intent to hinder, delay or defraud ATR in its efforts to collect on the Delaware judgment. Among other things, the transfers were made to an insider—namely, Bonilla's aunt—for purposes of preventing ATR from foreclosing on the properties to collect on its debt. Further, upon information and belief, Bonilla used a portion of the proceeds from these transfers to pay off at least one other loan owed by his wife. Finally, despite the fact that ATR was Bonilla's principal creditor, he neither informed ATR of the transfers of the properties nor offered to forward the proceeds to ATR.

40. Upon information and belief, at the time of the transfer of the Locust Street and Sequoia Court Properties, Bonilla had incurred or reasonably believed that he would incur a debt to ATR beyond his ability to pay.

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C. WITHOUT JUSTIFICATION, BONILLA HAS FAILED TO KEEP RECORDS FROM WHICH HIS FINANCIAL CONDITION COULD BE ASCERTAINED.

1. The 2006 Sequoia Court Refinancing

41. Upon information and belief, Bonilla also failed to keep records from which his financial condition could be ascertained within the meaning of 11 U.S.C. §727(a)(3).

42. Upon information and belief, Bonilla and his wife refinanced the Sequoia Court Property in January of 2006 by executing a new deed of trust and promissory note (the "Sequoia Court Refinancing") in favor of Lehman Brothers Bank. The Sequoia Court Refinancing constituted a "transfer" of the Debtor's property within the meaning of 11 U.S.C. §101(54).

43. Upon information and belief, as a result of the refinancing, Bonilla received a cash payment of $140,884.07.

44. Upon information and belief, on or about February 1, 2006, the $140,884.07 cash payment was deposited into Bonilla's individual checking account (#181868680) at Mission National Bank in San Francisco, California ("Mission National Bank").

45. Upon information and belief, on or about February 10, 2006, funds in the amount of $150,000.00 were transferred from Bonilla's individual checking account (#181868680) by way of telephone transfer to an unknown recipient. To date, Bonilla has failed to produce records accounting for the transfer of these funds, the recipient of the funds or the purpose of the transfer.

46. Bonilla failed to disclose the $140,884.07 cash payment that he received from the Sequoia Court Refinancing, or the February 10, 2006 transfer of $150,000.00, in response to Question No. 10 of the Statement of Financial Affairs that he filed in connection with his bankruptcy case, despite the fact that the Sequoia Court Refinancing took place within two years of the Petition Date.

47. Upon information and belief, Bonilla has failed, without justification, to maintain books, records, documents or papers from which the proceeds of the Sequoia Court Refinancing may be traced.

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2. The 2005 Locust Street Refinancing

48. Upon information and belief, Bonilla and his wife refinanced the Locust Street property in March of 2005 by executing a new deed of trust and promissory note (the "Locust Street Refinancing") in favor of World Savings Bank. That Locust Street Refinancing constituted a "transfer" of the Debtor's property within the meaning of 11 U.S.C. §101(54).

49. Upon information and belief, as a result of the Locust Street Refinancing, Bonilla received a cash payment of $197,512.07.

50. Upon information and belief, on March 22, 2005, that $197,512.07 cash payment was deposited into Bonilla's individual checking account (#181868680) maintained at Mission National Bank.

51. Upon information and belief, Bonilla has failed adequately to account for the $197,512.07 cash distribution. Although records supplied by Bonilla reveal that on May 19, 2005, he transferred $190,000.00 from his checking account into a savings account that he maintained at Mission National Bank, to date Bonilla has failed to produce records

accounting for any subsequent distribution of the funds for his savings account.

52. Bonilla failed to disclose the $197,512.07 cash distribution that he received from the Locust Street Refinancing, or the May 19, 2005 transfer of $190,000.00, in response to Question No. 10 of the Statement of Financial Affairs that he filed in connection with his bankruptcy case, despite the fact that the Locust Street Court Refinancing took place within two years of the Petition Date.

53. Upon information and belief, Bonilla has failed, without justification, to maintain books, records, documents or papers from which the proceeds of the Locust Street Refinancing may be traced.

3. Other Cash Distributions.

54. Upon information and belief, within the past three years there have been a number of other large transfers of money into and out of Bonilla's bank accounts at Mission National Bank for which Bonilla has failed to maintain books, records, documents or papers. Upon information and belief, these transfers include, but are not limited to:

- a March 17, 2004, deposit of $500,000.00 which was wire transferred into Bonilla's savings account number (#182840180) at Mission National Bank and, that same day, withdrawn by way of check number 161;
- a September 16, 2005 deposit of $250,000.00 which was deposited by way of telephone transfer into Bonilla's individual checking account (#181868680) at Mission National Bank, apparently in order to cover a withdrawal of $250,000 that had occurred two days earlier; and
- a January 9, 2006 deposit of $15,000.00 which was deposited by way of telephone transfer into Bonilla's individual checking account (#181868680) at Mission National Bank and withdrawn thereafter in multiple transactions.

55. Bonilla's bankruptcy schedules fail to disclose any of the foregoing transfers into or out of his accounts at Mission National Bank, despite the fact that the majority occurred within two years of the Petition Date.

56. Upon information and belief, Bonilla has also stated in loan documents filed in

connection with the Hillsborough Property in May of 2005 that he had a net worth of over $4 million.

57. Upon information and belief, since filing for bankruptcy, Bonilla has failed to adequately account for the transfers or assets alleged above.

58. Upon information and belief, Bonilla has failed, without justification, to maintain books, records, documents or papers from which the transfers and assets alleged above may be traced.

D. BONILLA HAS FAILED TO EXPLAIN SATISFACTORILY THE ABSENCE OF ASSETS RELATED TO THE SEQUOIA COURT REFINANCING, THE LOCUST STREET REFINANCING OR THE OTHER CASH DEPOSITS ALLEGED ABOVE.

59. Bonilla also failed to explain satisfactorily the loss or deficiency of assets that could satisfy at least a portion of his debt to ATR under 11 U.S.C. §727(a)(3).

60. Bonilla failed to list in his bankruptcy schedules the cash distributions that he received from the Sequoia Court Refinancing or the Locust Street Refinancing, despite the fact the refinancings constitute transfers that occurred within two years of the date of the bankruptcy petition.

61. Bonilla also failed to disclose any of the other transfers of money into or out of his accounts at Mission National Bank, despite the fact that the majority of these transfers occurred within two years of the Petition Date.

62. To date, Bonilla has failed to provide satisfactory explanation for the ultimate disposition of the substantial funds that he received from the Sequoia Court Refinancing or the Locust Street Refinancing. In addition, Bonilla has also failed to provide satisfactory explanation for the ultimate disposition of the additional cash deposits alleged above.

FIRST CLAIM FOR RELIEF

(Denial of Discharge Under 11 U.S.C. §727(a)(2)(A))

63. ATR incorporates by reference paragraphs 1-62 inclusive, as though fully set forth herein.

64. Bonilla's transfers of the Hillsborough, Sequoia Court and Locust Street Properties, having occurred within one year of the Petition Date and having been made with the intent to hinder, delay or defraud ATR, require that the Court deny him a discharge pursuant to Section 727(a)(2)(A).

65. Based on the foregoing, ATR respectfully requests that the Court enter a judgment that Bonilla is not entitled to a discharge in bankruptcy.

SECOND CLAIM FOR RELIEF

(Denial of Discharge Under 11 U.S.C. §727(a)(3))

66. ATR incorporates by reference paragraphs 1-62 inclusive, as though fully set forth herein.

67. Bonilla's failure to maintain books, documents, records and papers from which his financial condition or business transactions might be ascertained—specifically his failure to maintain books, documents, records and papers related to the cash distributions he received from the Sequoia Court Refinancing, the Locust Street Refinancing and the other transfers of money alleged above—require that the Court deny him a discharge under 11 U.S.C. §727(a)(3).

68. Based on the foregoing, ATR respectfully requests that the Court enter a judgment that Bonilla is not entitled to a discharge in bankruptcy.

THIRD CLAIM FOR RELIEF

(Denial of Discharge Under 11 U.S.C. §727(a)(5))

69. ATR incorporates by reference paragraphs 1-62 inclusive, as though fully set forth herein.

70. Bonilla's failure to explain satisfactorily the loss or deficiency of assets related to the Sequoia Court Refinancing, the Locust Street Refinancing and/or the other cash deposits alleged above—despite the fact that those assets would satisfy as least a portion of his debt to ATR—require that the Court deny him a discharge under 11 U.S.C. §727(a)(5).

71. Based on the foregoing, ATR respectfully requests that the Court enter a judgment that Bonilla is not entitled to a discharge in bankruptcy.

FOURTH CLAIM FOR RELIEF

(Non-Dischargeability Of Debt Under 11 U.S.C. §523(a)(4))

72. ATR incorporates by reference paragraphs 1-62 inclusive, as though fully set forth herein.

73. In his capacity as Director of a Delaware corporation, Bonilla owed fiduciary duties to ATR, the Delaware Holding Company's minority shareholder, that predated the debt in this case. Those pre-existing fiduciary duties imposed upon Bonilla the responsibility for safeguarding the value of the assets of the Delaware Holding Company and, thereby, preserving the value of ATR's interest as a minority shareholder in the Delaware Holding Company.

74. Further, as a director of a Delaware corporation, Bonilla stood in the position of a trustee for the shareholders of the Delaware Holding Company, including ATR. That trust relationship predated the debt owed by Bonilla to ATR and existed without reference to that debt.

75. Bonilla's failure—as found by the Delaware Chancery Court—to monitor Araneta's actions, to prevent him from removing assets from the Delaware Holding Company to his family members without consideration, or to take any steps to protect ATR's interest as a minority shareholder, facilitated and enabled Araneta's wrongful transfer of assets from the Delaware Holding Company, resulting in the misappropriation of funds held in a fiduciary capacity. Further, by failing to respond to ATR's discovery requests in the Delaware action, Bonilla failed properly to account for the investment ATR made in the Delaware Holding Company.

76. As a result of these actions, Bonilla's Judgment Debt to ATR arises from "fraud or defalcation while acting in a fiduciary capacity," within the meaning of 11 U.S.C. Section 523(a)(4) and therefore should be excepted from discharge.

77. Based on the foregoing, ATR respectfully requests that the Court enter judgment that the $24,981,069.66 Judgment Debt that Bonilla owes to ATR (less any payments already received) is non-dischargeable under Section 523(a)(4).

PRAYER FOR RELIEF

78. WHEREFORE, ATR prays that judgment be entered in ATR's favor and against Bonilla as follows:

a. For a determination that Bonilla is not entitled to a discharge under 11 U.S.C. §727(a)(2)(A), (a)(3), and/or (a)(5);

b. In the alternative, for a determination that the $24,981,069.66 Judgment Debt that Bonilla owes to ATR (less any payments received) is not dischargeable under 11 U.S.C. §523(a)(4);

c. For relief from the automatic stay imposed by the filing of the petition in this case, so that ATR may pursue collection of their claim;

d. For recovery of ATR's costs and expenses in connection with this adversary proceedings; and

e. For such other relief against Bonilla and in favor of ATR as this Court deems just and equitable.

Dated: July 23, 2007

Respectfully,

MICHAEL J. BAKER
WILLIAM J. LAFFERTY
MATTHEW L. BELTRAMO
HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN
A Professional Corporation

By: _____
WILLIAM J. LAFFERTY

Attorneys for Creditors ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC.

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN

CORPORATE DISCLOSURE STATEMENT UNDER FEDERAL RULE OF BANKRUPTCY PROCEDURE 7007.1

Please be advised that the following corporations own 10 percent of more of any class of stock in Plaintiff and Creditor ATR-Kim Eng Financial Corporation:

- ATR Holdings, Inc.
- Kim Eng Holdings Limited

Please be advised that Plaintiff and Creditor ATR-Kim Eng Capital Partners, Inc. is a wholly owned subsidiary of Plaintiff and Creditor ATR-Kim Eng Financial Corporation.

Dated: July 23, 2007

Respectfully,

MICHAEL J. BAKER
WILLIAM J. LAFFERTY
MATTHEW L. BELTRAMO
HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN
A Professional Corporation

By: _____
WILLIAM J. LAFFERTY

Attorneys for Creditors ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC.

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Westlaw.

Not Reported in A.2d
Not Reported in A.2d, 2006 WL 3783520 (Del.Ch.)
(Cite as: Not Reported in A.2d)

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ATR-Kim Eng Financial Corp. v. Araneta
Del.Ch.,2006.
Only the Westlaw citation is currently available.
UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.

ATR-KIM ENG FINANCIAL CORPORATION, and ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs,
v.
Carlos R. ARANETA, Hugo Bonilla, Liza Berenguer and Marites Vicente, Defendants,
andPMHI HOLDINGS CORPORATION, (f/k/a LBC Global Corporation), a Delaware corporation, Nominal Defendant.

No. CIV.A. 489-N.

Submitted: Oct. 9, 2006.
Decided: Dec. 21, 2006.

Steven T. Margolin, Esquire, Richard D. Heins, Esquire, Ashby & Geddes, Wilmington, Delaware; Sidney Todres, Esquire, Epstein Becker & Green P.C., New York, NY, for Plaintiff.
Richard D. Allen, Esquire, Thomas W. Briggs, Jr., Esquire, Morris, Nichols, Arsht & Tunnell LLP, Wilmington, for Defendants.

MEMORANDUM OPINION

STRINE, Vice Chancellor.

I. *Introduction*

*1 Plaintiffs ATR-Kim Eng Financial Corp. ("ATR Financial") and ATR-Kim Eng Capital Partners, Inc. ("ATR Capital") (collectively, "ATR") own 10% of the shares of a holding company-PMHI Holdings Corp. (f/k/a LBC Global Corp.) (the "Delaware Holding Company"). ATR claims that defendant Carlos Araneta, who controlled the remaining 90% of the Delaware Holding Company's equity and served as chairman of its board, caused the corporation to transfer its key assets-its ownership of several businesses worth over $35 million (the "LBC Operating Companies")-to members of his family in violation of his fiduciary duties. The Delaware Holding Company was formed precisely to enable ATR to share with Araneta in the benefits of owning the LBC Operating Companies. But, after Araneta denuded the Delaware Holding Company of those assets, ATR was left with only a minority stock ownership position in a floundering joint venture that it had undertaken with Araneta, a position that is worth very little. Meanwhile, Araneta and his family were left with sole control of the LBC Operating Companies, which, from the record, appear to be thriving.

Furthermore, ATR claims that the other members of the board of directors of the Delaware Holding Company, defendants Hugo Bonilla and Liza Berenguer, are jointly and severally liable for this harm because they failed to take any steps to monitor Araneta and prevent his self-dealing. Bonilla was the head of Araneta's operations in the United States, and Berenguer served as the Chief Financial Officer of his worldwide enterprise. They essentially admit that they regarded themselves as mere employees of Araneta and failed to take any steps to fulfill their fiduciary duties to the Delaware Holding Company. As directors, they were charged with protecting the interests of their corporation and its stockholders. Yet, Bonilla and Berenguer allowed Araneta to do whatever he wanted, without any examination of whether his conduct benefited the Delaware Holding Company and all of its stockholders, rather than simply Araneta personally.

In this post-trial opinion, I find that Araneta breached his duty of loyalty by impoverishing the Delaware Holding Company for his own personal enrichment. Bonilla and Berenguer also breached their duty of loyalty. Having assumed the important fiduciary duties that come with a directorship in a Delaware corporation, Bonilla and Berenguer acted as-no other word captures it so accurately-stooges for Araneta, seeking to please him and only him, and having no regard for their obligations to act loyally towards the corporation and all of its stockholders. Such behavior is not indicative of a good faith error in judgment; it reflects a conscious decision to approach one's role in a faithless manner by acting as a tool of a particular

stockholder rather than an independent and impartial fiduciary honestly seeking to make decisions for the best interests of the corporation. Although it is clearly the case that Araneta is the most culpable of the defendants, Bonilla and Berenguer are accountable for their complicity in his wrongful endeavors.

*2 To the point of Araneta's misconduct, the sad reality is that his behavior as a director of the Delaware Holding Company and as a defendant in this litigation clearly manifests: (1) an intent on his part to defraud and injure ATR by consummating a de facto liquidation of the Delaware Holding Company in which its value was siphoned out entirely to the Araneta family, to the exclusion of ATR; (2) a willingness to put an innocent administrative employee of his at risk by falsely suggesting that she alone (rather than Araneta, Bonilla, and Berenguer as a group) comprised the board of directors of the Delaware Holding Company at the time Araneta impoverished it, all in a cynical attempt to avoid this court's jurisdiction and accountability for his own actions; (3) a contempt for the judicial process by providing a false and incomplete response to a legitimate demand for books and records under 8 *Del. C.* § 220; (4) a desire to obstruct the efficient procession of this litigation by making the discovery process unduly expensive and by failing to promptly produce required discovery; and (5) a shamelessness about telling lies so extreme as to make it impossible to address all of the numerous false statements and assertions he made both from his own lips and through theories he provided to his counsel.

Because of the difficulty of implementing a remedy that would undo the de facto liquidation of the Delaware Holding Company that Araneta effected, I enter an order requiring Araneta to pay to ATR a judgment based on the price ATR originally paid for its 10% equity stake in the Delaware Holding Company, plus pre-judgment and post-judgment interest pegged to a cost of capital determined by reference to an agreement between Araneta and ATR that provides the most reliable benchmark of the interest rate required to make ATR whole and to avoid unjustly enriching Araneta. This judgment may well understate the relief due ATR, as it appears that the LBC Operating Companies are booming. But ATR is willing to accept this more limited remedy and it is the most efficient means of providing it fair recourse.

Given Araneta's egregious misconduct both before and during this litigation, fee shifting under the bad faith exception to the American Rule is in order. Only through such an award will ATR be made whole for the excessive costs it had to incur in order to address Araneta's faithless acts, and only through such an award will Araneta's misuse of a Delaware corporation be rectified. The fee shifting award will also extend to any collection efforts ATR must expend in attempting to collect on this judgment.

Bonilla and Berenguer will be held jointly and severally liable for the monetary judgment but not for the fee-shifting award.

II. *Factual Background*

These are the facts as I find them after trial.[FN1]

FN1. Citations to plaintiffs' exhibits ("PX ___"), defendants' exhibits ("DX ___"), or the trial transcript ("Tr. at ___") are illustrative. Other portions of the record often support the same findings.

A. *Overview Of The Key Arrangements Between Araneta And ATR*

Before describing the origins of the current dispute between ATR and Araneta in more detail, it is useful to provide a basic overview of the parties and how they came to form the Delaware Holding Company.

*3 Araneta first met ATR's chairman Ramon Arnaiz when they were in kindergarten in the Philippines. During their school days, Araneta and Arnaiz became close friends. After many years of friendship, the two fell out of touch as each embarked on his own career.

Araneta left the Philippines to attend college in the United States. After completing his studies, Araneta returned home to work in his family's business-an empire of companies run from the Philippines that share the initials LBC in their names (collectively, "LBC").[FN2] Araneta gained prominence by developing LBC Express, Inc. (f/k/a LBC Air Cargo), a Phil-

ippine version of Federal Express, into an international money remittance business that facilitates and profits from wire transfers made by Filipino expatriates who have gone abroad to make a living but continue to support their families still living in the Philippines. As a result of his efforts, Araneta came to dominate and control LBC and is the ultimate manager for the thousands of employees working for LBC and the hundreds of locations owned by LBC around the globe.[FN3]

> FN2. LBC Development Corp., a corporation organized and existing under the laws of the Philippines, was the primary holding company for the Araneta family businesses before the events giving rise to this dispute. Through this entity, the Aranetas owned the non-U.S. LBC Operating Companies that provided courier and money remittance services in the Philippines and to Filipino expatriates working in other nations. These entities include the following companies and their subsidiaries: LBC Domestic Franchise Co., Inc., LBC Express, Inc., LBC Mabuhay Development Philippine Corp., LBC International, Inc., and LBC Development Bank. The Aranetas also own LBC Holdings USA Corp. (overseen by defendant Bonilla), which serves Filipinos working in the United States.
>
> FN3. Although Araneta has at various times used his children to directly hold stock in the LBC Operating Companies, his children are subject to his will as to these matters. Araneta exercises de facto and clear control over his family's worldwide holdings.

Meanwhile, Arnaiz went into the financial services field. He gained prominence by spearheading the revitalization of a major financial firm's Hong Kong office. Following that success, Arnaiz ("A"), along with Manuel Tordesillas ("T") and Lorenzo Roxas ("R"), founded ATR, a Philippine corporation licensed to provide investment and financial services From its creation, ATR has been essentially a capital provider, helping businesses raise capital and investing its own funds (and those of its investors) in various enterprises.

In the late 1990s, Araneta and Arnaiz reunited. At that time, Araneta turned to Arnaiz and ATR for investment banking assistance on behalf of his LBC enterprise. Initially, Araneta engaged ATR to search for capital and to prepare LBC for a public offering. After a while, however, the relationship changed.

In 1999, ATR began investigating an opportunity to purchase a controlling interest in The Professional Group Plans, Inc., a corporation that sold "pre-need" insurance policies designed to cover expenses (such as educational and health costs) that buyers expected to face in the future (the "Pre-Need Company").[FN4] Seeing potential synergies in this industry between ATR's financial acumen and LBC's logistical network, which was well-positioned to attract Filipino customers who had traditionally purchased these policies, Arnaiz offered to structure the investment in the Pre-Need Company as a joint enterprise with Araneta. After some negotiation, Araneta agreed to participate in the deal ATR proposed.

> FN4. According to Araneta, "A pre-need company is like ... an insurance plan except that an insurance plan is something that you sell but you don't know when the event will happen. In the case of the pre-need, it's the same thing but a date is set." Tr. at 20. "In other words, you keep on paying monthly maybe for 20 years; and if anything happens to you within that 20-year period you can make a claim for your health or for your education." *Id.*

Based on this understanding, ATR and Araneta executed two contracts-an "Undertaking Agreement" [FN5] and a "Joint Venture Agreement" [FN6]-that set out the terms of their relationship and laid the groundwork for the Delaware Holding Company's incorporation. Through the Joint Venture Agreement, ATR and Araneta bought a controlling interest in the Pre-Need Company, and as part of this transaction, ATR advanced $3.922 million on Araneta's behalf (the "Advances").[FN7] In exchange for the Advances, Araneta pledged, in the Undertaking Agreement, to contribute the LBC Operating Companies along with

his newly acquired interest in the Pre-Need Company to a new holding company and to issue to ATR a 10% minority interest in that entity.[FN8]

FN5. PX 1.

FN6. PX 2.

FN7. The joint investment in the Pre-Need Company was made through one of ATR's subsidiaries, Professional Mutual Holdings, Inc. ("Professional Holdings") in which both Araneta and ATR had acquired 50% interests at a price of 37.5 million pesos (about $937,500) each. Using its 75 million pesos in contributed capital as well as an additional 239 million pesos nominally contributed on equal terms by ATR and Araneta (119.5 million pesos each), Professional Holdings purchased 80% of the Pre-Need Company. In this transaction, ATR advanced Araneta's portion as well as its own. As a result, Araneta owed ATR 157 million pesos (approximately $3.922 million).

FN8. The Undertaking Agreement specifically provided that Araneta would transfer the following assets to the Delaware Holding Company:
(i) LBC Domestic Franchise Co., Inc. and its subsidiaries; (ii) LBC Express, Inc. and its subsidiaries; (iii) LBC Mabuhay Development Philippine Corp. and its subsidiaries; (iv) LBC Holdings USA Corp. and its subsidiaries; (v) LBC International, Inc. and its subsidiaries (including all remittance businesses outside of LBC Holdings USA Corp.); (vi) LBC Development Bank; (vii) the foreign exchange business arising from the remittance transactions involving any and all of the above companies.
PX 1 at 2. For simplicity's sake, I refer to these as the LBC Operating Companies.

*4 To protect ATR's investment in the LBC Operating Companies, the Undertaking Agreement granted ATR contractual protections, including the right to a seat on the board of directors of any holding company that Araneta ultimately formed as well as a five-year put option, which, when exercised, required Araneta to buy out ATR's interest at the higher of (i) the issue price of ATR's shares plus a premium of between 22% and 25% per year, or (ii) the adjusted book value of ATR's shares.[FN9] Likewise, to safeguard their joint investment in the Pre-Need Company, ATR and Araneta executed a Stockholders Agreement which they attached to their Joint Venture Agreement (the "Stockholders Agreement") [FN10]. The Stockholders Agreement evenly divided the eight (out of ten) board seats secured by ATR's and Araneta's joint 80% interest in the Pre-Need Company, and unanimously appointed Topax Colayco, the residual 20% shareholder in the Pre-Need Company, to be its President and CEO.

FN9. ATR also had an option to require Araneta to cede the shares the Advances had purchased as well as all rights and interests secured by the Advances if within a period of three months from the closing of the Joint Venture Agreement the LBC Operating Companies were not transferred into the holding company. Although it is undisputed that the holding company was not formed or funded within three months, ATR chose not to exercise this option.

FN10. DX 1 at Annex "A".

Although the Undertaking Agreement did not require that the holding company it contemplated be a Delaware, or even an American, entity, Araneta perceived the United States as a favorable jurisdiction in which to raise capital and viewed Delaware as a tax haven. In particular, Araneta viewed a Delaware entity as a vehicle that could be used to access the American capital markets through an initial public offering of stock. As a result, in January 2000, Araneta incorporated the Delaware Holding Company and presented ATR with 3,000 of its shares (10%) while personally retaining control over the residual 27,000 shares (90%). Likewise, Araneta appointed and dominated the Delaware Holding Company's board of directors, which consisted of himself, defendant Berenguer (Araneta's niece and the CFO of the LBC group of companies), and defendant Bonilla (the head

of LBC's U.S. operations).[FN11]

> FN11. Tr. at 109-15. I also note that ATR was not permitted to exercise its contractual right to appoint a director. By letter dated June 24, 2003, Arnaiz explained, "We were never provided regular, updated financials and a board seat ... in spite of our repeated request[s]." PX 51.

Thus, after 1999, ATR and Araneta were entwined in several ways: (1) they were contractually linked through the Undertaking Agreement, the Joint Venture Agreement, and the Shareholders Agreement; (2) they shared equal shareholder and directorial interests in the Pre-Need Company; (3) they possessed inverse majority and minority shareholder interests in the Delaware Holding Company; and perhaps most importantly, (4) Araneta and ATR were tied together through Araneta's friendship with Arnaiz.

B. *The Personal Nature Of This Dispute*

ATR's claims against Araneta boil down to an allegation that he abused his position of control over the Delaware Holding Company. Specifically, ATR claims that Araneta transferred the LBC Operating Companies from the Delaware Holding Company to his children for no consideration without notice to ATR and without following the process required by Delaware law.

Araneta does not dispute that the LBC Operating Companies are now owned by his family or that ATR has no interest in those assets through its minority ownership of the Delaware Holding Company. He merely claims never to have transferred ownership of the LBC Operating Companies to the Delaware Holding Company in the first place. He says that ATR knew that. What he never says is why ATR would have made a nearly $4 million payment to acquire 10% of an entity with no valuable assets. Further, in the event that I conclude that he is lying when he says that the Delaware Holding Company never owned the LBC Operating Companies, Araneta offers only the half-hearted and wholly-illogical defense that he was permitted to reclaim the LBC Operating Companies without payment through an accounting "offset" because he was the one who initially contributed the LBC Operating Companies to the Delaware Holding Company.

*5 To understand how a case as stark as this actually resulted in a trial, rather than a voluntary settlement by Araneta, it is useful to return to Araneta's relationship with his old friend, Ramon Arnaiz. That's right, this case is personal.

Araneta has known Arnaiz since they were five years old. As Araneta testified, he and Arnaiz were "very, very close friends, buddy buddies" who sat next to each other in classes and had parents who played mahjong together several times a week while they were growing up.[FN12] Although Araneta and Arnaiz went to different colleges, and ultimately into different careers, "whenever [they] saw each other [before this dispute], it was really a warm[ ] meeting ."[FN13]

> FN12. Tr. at 16.
>
> FN13. Tr. at 17.

But, as a result of their business dealings, Araneta's friendship with Arnaiz has ended. Araneta testified that he considers this case a "personal fight" between himself and Ramon Arnaiz.[FN14] He stated in his deposition and confirmed at trial that he did not think his co-directors had "anything to do with this tie-up with ATR."[FN15] And, perhaps most tellingly, he admitted on cross examination that at least "to some extent" this litigation was "over the disintegration of [his] friendship" with Arnaiz.[FN16]

> FN14. Tr. at 104.
>
> FN15. *Id.*
>
> FN16. *Id.*

That disintegration began in November 2002 when ATR sold its 50% interest in Professional Holdings, the corporation that owned 80% of the Pre-Need Company. Having closely aligned himself with Arnaiz and ATR, Araneta felt betrayed by that action. In compliance with the Shareholders Agreement, which secured ATR's right to sell its Professional Holdings shares as long as Araneta was given a right of first re-

fusal, ATR offered its shares to Araneta, but he refused to purchase them.[FN17] After Araneta declined, ATR sold its interest to Topax Colayco (the "Colayco Sale") giving Colayco co-equal control with Araneta over Professional Holdings and thus over Professional Holdings's 80% control bloc in the Pre-Need Company. But, because Colayco already directly owned the residual 20% of the Pre-Need Company that Professional Holdings did not, Araneta understandably viewed himself as having less leverage than Colayco in this dynamic.

FN17. *See* PX 44 (offering shares); Tr. at 59 (rejecting offer); *see also* DX 1 at Annex "A" § 5 (describing rights and restrictions regarding transfers of Professional Holdings shares).

Notwithstanding ATR's contractual right to sell its interest in Professional Holdings and Araneta's own failure to exercise his right of first refusal, Araneta felt victimized by Arnaiz and ATR and blamed them for subjugating him to the role of a minority investor under Colayco's de facto control. Even though Colayco had been a longstanding 20% shareholder in the Pre-Need Company, had managed its day-to-day operations as its President and CEO with Araneta's consent, and had served on the board of the Pre-Need Company with Araneta from the time Araneta first invested in the Pre-Need Company, Araneta testified that he felt as though he was "stuck running this company with a stranger." [FN18] Most important, he felt that ATR had done the sticking.[FN19]

FN18. Tr. at 86-90; DX 1 at Annex "A" § 3.03.

FN19. Araneta testified, "When [ATR] decided to get out of the business, I said 'My God, that's the very essence why I got involved in this business.... I don't understand the pre-need business.... The very person you're selling it to, I don't even know. I came to know him because of you.... How can you do this to me?" Tr. at 60-61.

Araneta allowed this hostility to affect his management of the Delaware Holding Company. After the Colayco Sale, Araneta withheld information, effectively closed the lines of communication with ATR, and eventually transferred all of the LBC Operating Companies out of the Delaware Holding Company.

C. *The Discovery Of Araneta's Misconduct*

*6 Araneta began to exact his revenge soon after the Colayco Sale was completed. In the months that followed, ATR repeatedly requested information on the condition of the Delaware Holding Company in which it still had nearly $4 million invested. But Araneta summarily rebuffed those requests. Araneta testified that any request ATR made for information during the entire 2003 calendar year went ignored because he was "no longer talking to them because [he was] upset with Mr. Arnaiz." [FN20] Throughout the first half of that year, lawyers in the Philippines exchanged letters regarding the "ongoing fight" between Araneta and Arnaiz, but were unable to resolve the matter. [FN21]

FN20. Tr. at 235.

FN21. Tr. at 233.

Fed up, ATR, through its attorneys, sent a formal books and records demand letter to Araneta on July 18, 2003.[FN22] In that letter, ATR exercised its right as a stockholder of a Delaware corporation to request financial statements of the Delaware Holding Company as well as documents showing the Delaware Holding Company's ownership of the LBC Operating Companies and Araneta's interest in the Pre-Need Company.[FN23] In hopes of a response, ATR sent additional demand letters to the Delaware Holding Company's corporate secretary at its registered address and to Araneta's attorney in the Philippines on the same day as it sent its letter to Araneta.[FN24] These additional demand letters sought to review the Delaware Holding Company's stock ledger, the records of all business transactions of the corporation, and the minutes of every meeting of the stockholders and directors of the Delaware Holding Corporation since its incorporation.[FN25]

FN22. PX 53 at 1-3. ATR copied Araneta's son, his lawyer, and the head of LBC's U.S. operations, defendant Bonilla, on this de-

mand. *Id.* at 3.

FN23. *Id.* at 4-9.

FN24. *Id.* (copying Araneta, his son, and Bonilla on each).

FN25. *Id.*

Each of ATR's demand letters warned that ATR would file suit to protect its interests if its demands were denied.[FN26] Yet, even knowing legal action was imminent, Araneta testified that he was "so angry with Mr. Arnaiz" that he "ignored these letters" and prevented ATR from gaining the information it sought.[FN27] Starved for information, ATR filed an action under 8 *Del. C.* § 220 in this court on October 27, 2003. But still irked by ATR's decision to sell its interest in Professional Holdings, Araneta "deliberately ignored" that lawsuit and instructed Bonilla not to provide the requested information. [FN28]

FN26. *See* PX 53 at 2 ("If we do not receive any response from you within ten (10) days ... we shall be constrained to initiate the appropriate legal actions ... to protect our client's interests."); *id.* at 5, 8 (providing similar warnings).

FN27. *Id.* at 238.

FN28. *Id.* at 239. Specifically, when discussing the § 220 litigation with Bonilla, Araneta told him, "Don't mind it." *Id.*

Only after being ordered by this court to turn over the records requested by ATR did Araneta do so. On January 14, 2004, Araneta produced a "Compliance" [FN29] that purported to include all available documents but totaled only nine pages and failed to include many essential corporate papers.[FN30] The nine pages that Araneta did produce, however, included three documents that caused ATR great concern. Those documents-two balance sheets and a purported resolution of the board of directors-led ATR to believe that Araneta had conducted a de facto (and non-pro rata) liquidation of the Delaware Holding Company's assets and that Araneta was attempting to escape responsibility for that act.

FN29. PX 54.

FN30. In response to the pithy Compliance, ATR was permitted to depose Mr. Bonilla under 10 *Del. C.* § 368. That deposition uncovered several documents that had not been previously disclosed including the bylaws of the corporation, the corporate kit, and various financial and tax-related working papers. Finding that the corporation had not complied with its December 22 order, the court awarded ATR its attorneys' fees in prosecuting the § 220 action. Araneta's inappropriate behavior continued throughout the present litigation wherein he was repeatedly non-responsive, delayed the proceeding, and had to be admonished for exhibiting "close to contemptuous behavior" and having committed a "clear violation" of applicable rules by engaging in a "persistent pattern [of] flouting obligations that he owes under the rules of this Court and, frankly, under the Delaware General Corporation Law." *See* 4/20/04 Hearing Tr. at 10, 57, 59, 61, 67 (noting that "the horsing around, the inappropriate behavior, began long ago").

The two balance sheets that manifest the de facto liquidation are dated March 2003 and December 2003, respectively. Under Philippine accounting conventions, as adopted by the parties, both balance sheets reflect "investments" and "liabilities" in an unusual way. On the Delaware Holding Company's books, "investments" referred to the LBC Operating Companies and the Professional Holdings shares purchased for Araneta by ATR's Advances, which were to be owned by the Delaware Holding Company under the terms of the Undertaking Agreement. "Liabilities" represented the pro rata amounts due to Araneta and ATR as a result of the equity positions that each gained for their capital contributions. As of March, the Delaware Holding Company's balance sheet reflected approximately $36 million in "investments" and approximately $39 million in "liabilities." But, by December, the balance sheet showed only $937,500 in "investments" and $3.922

million in "liabilities." These financial statements indicated that during the last nine months of 2003 Araneta stripped the Delaware Holding Company of the LBC Operating Companies. The only operating asset he left in the Delaware Holding Company was ownership of the de facto minority position in the Pre-Need Company.

*7 A board of directors resolution Araneta produced in the Compliance is relevant to considering Araneta's intentions. In that document, dated May 22, 2003, Araneta putatively resigns his directorship along with Berenguer and Bonilla effective that day. In their stead, Araneta's secretary, Vicente, was supposedly appointed that day as the President and sole director of the Delaware Holding Company. As I discuss later, Vicente never assumed those positions and Araneta, Bonilla and Berenguer never left the Delaware Holding Company board. Araneta seems to have created this fiction in order to set up a phony defense to this court's jurisdiction and to claim that Vicente was responsible for any misfeasance at the Delaware Holding Company after May 22, 2003-a futile exercise in "plausible deniability."

D. *The Parties' Claims*

Based on the balance sheets unearthed in the § 220 action, ATR filed this lawsuit on June 3, 2004. ATR's complaint alleges direct and derivative injuries caused by the removal of the LBC Operating Companies, which were valued at nearly $36 million, from the Delaware Holding Company between March and December 2003. ATR claims that it was harmed as a stockholder of the Delaware Holding Company when Araneta effectively made a $36 million liquidation payment to his family without following the required process and without distributing to ATR its pro rata portion thereof. ATR also alleges that the corporation itself was injured by this transaction because it received no substantial consideration for the transfer of substantially all of its assets to the Araneta family.

In response, Araneta mounted three shifting defenses. First, he raised a "scapegoat" jurisdictional defense based on his purported resignation from the board of directors.[FN31] Further, in the event his jurisdictional argument proved unpersuasive, Araneta attempted to explain that contrary to his own contemporaneous admissions in e-mails, letters, and financial statements-and, yes, even tax filings-the LBC Operating Companies were never transferred into the Delaware Holding Company in the first instance because of tax issues.[FN32] Ultimately, in his deposition and at trial, perhaps recognizing the difficulties inherent in this "believe-me-now-I-was-lying-then" tax defense, Araneta proffered a half-hearted justification for the transfer of assets as an "offset" against the "liability" his family was owed for having contributed those assets.[FN33] If his implausible excuses were not expending ATR's and this court's limited resources and impeding ATR's just claim for recompense, Araneta's brazen and abundant falsehoods might be amusing. Because they have these costs, they are appalling.

FN31. Araneta raised this defense in his very first pleading, a Motion to Dismiss or Stay filed in July 6, 2004. Araneta also made this argument as his first affirmative defense in his Answer dated August 2, 2004.

FN32. This "tax defense" first appeared with along with the jurisdictional defense in Araneta's Motion to Dismiss or Stay. Over the two years since then, this argument gained prominence, becoming the focus of Araneta's pre-trial briefing.

FN33. *See* Tr. at 253-58 (referencing deposition testimony).

1. *Araneta's Scapegoat Defense*

In May 2003, Araneta claims that the composition of the board of directors of the Delaware Holding Company changed. Araneta asserts, based on a purported board resolution dated May 22, 2003 (the "May 2003 Resolution"), that he, Bonilla and Berenguer resigned as directors, and were replaced by one of his employees at LBC in the Philippines, Marites Vicente.

*8 Vicente is the assistant to the executive secretary to the chairman at LBC, which means that she reports directly to Araneta's secretary and ultimately to Araneta himself.[FN34] In this position, Vicente did the typing and filing for Araneta and his in-house at-

torneys, who included Ronaldo Tugonon, and sat at a desk just outside Araneta's office.[FN35] As part of her responsibilities, Vicente testified that she was regularly called upon to sign documents, many of which she did not understand, at the request of her bosses-Araneta and his attorneys.[FN36] For her work, Vicente earned a salary of 11,500 pesos (less than $300) per month. Valuing her job, Vicente never refused to perform the tasks her superiors asked her to perform, and in the three years she had worked for LBC, she never mustered the courage to ask Araneta for a raise even though she believed she deserved one.[FN37] In this light, Vicente admits that her signature appears on the Compliance, the May 2003 Resolution, and other corporate documents, but she denies that she understood those documents or ever knowingly became a director and officer of the Delaware Holding Company as Araneta has suggested.[FN38]

FN34. Vicente at 5-6.

FN35. Vicente at 4-5.

FN36. *See, e.g.*, Vicente at 43-45, 47, 50, 58.

FN37. Vicente at 3-4, 23-24.

FN38. *See, e.g.*, Vicente at 42-50, 57-58

Araneta's contention that Vicente was appointed as a director and officer of the Delaware Holding Company is likewise without support in the record. Neither the actions nor testimony of Araneta, Bonilla, Berenguer or Vicente are consistent with a complete overhaul of the board of directors of the Delaware Holding Company in May 2003. Vicente testified that she was never a director or officer of the Delaware Holding Company and that she was "surprised" to learn that she was listed as having those positions .[FN39] In fact, Vicente did not even know the name of the Delaware Holding Company and did not have any idea what the May 2003 Resolution was when it was shown to her.[FN40] Perhaps this should have been unsurprising because at his deposition, Araneta testified that he had appointed Vicente to those roles because "[s]he was there" and "[s]he looked timid." [FN41] Bonilla and Berenguer were likewise unaware of Vicente's appointment to the board. Berenguer testified that she did not learn of Vicente's apparent appointment until October or November of 2004. [FN42] Bonilla agreed that it was "news to [him] upon receiving [the Compliance containing the May 2003 Resolution while testifying] that [Vicente] was the president and director of the company." [FN43] Even Araneta did not acknowledge the role he purportedly assigned to Vicente-failing to name her as one of his co-directors at his deposition.[FN44]

FN39. Vicente at 56.

FN40. Vicente at 37-38, 46-47.

FN41. Araneta Dep. at 264.

FN42. Berenguer at 193.

FN43. Bonilla I at 85.

FN44. Tr. at 259-60.

The actions of Araneta, Bonilla, and Berenguer further manifested their ongoing service as directors after May 22, 2003. On May 23, 2003, the very day after he claims to have resigned, Araneta himself approved a board resolution-which he signed as a director!-to change the name of the Delaware Holding Company (the "Name Change").[FN45] Soon thereafter, Bonilla received a copy of the Name Change, and proceeded to prepare, sign, and file a certificate amending the Delaware Holding Company's charter on June 17, 2003, in accordance with the Name Change.[FN46] Moreover, in his mind, Bonilla continued to serve as a director of the Delaware Holding Company until December 2003. [FN47] Consistent with the notion that the leadership of the Delaware Holding Company remained unchanged until late 2003 or early 2004, Berenguer testified that she was still acting in her fiduciary capacity in January 2004. [FN48] Finally, even Araneta supported this notion when he stated that his co-directors at the time he prepared a balance sheet dated December 31, 2003 were Berenguer and Bonilla, but not Vicente.[FN49]

FN45. PX 54 at 7.

FN46. PX 54 at 6.

FN47. Bonilla I at 44-45.

FN48. *See* Berenguer at 139-45; Berenguer Ex. 2, at 21 (establishing that Berenguer signed a stock certificate as an officer of the Delaware Holding Company on January 9, 2004). I do note that Berenguer's testimony regarding her board service was a bit uncertain. She testified that she resigned from the boards of all companies except LBC Development and LBC Development Bank sometime during the period from April or May 2003 through December 2003. But, she was unable to be more specific about her resignation from the Delaware Holding Company's board than to agree that she believed she resigned "at some point after May 2003," and that she thought it might have been "[a]ny time from May ... to August." Berenguer at 82-83.

FN49. Tr. at 259-60.

*9 Thus, only the date on the May 2003 Resolution itself seems to indicate that a transition of the board of directors occurred at the Delaware Holding Company on May 22, 2003. Yet, even this resolution is suspect. At trial, ATR presented evidence that the substance, format, and notary stamps used in preparing this resolution were consistent with it being created in January 2004-at the same time as the Compliance-rather than in May 2003-a day before the Name Change.[FN50] Specifically, the Name Change refers to the Delaware Holding Company as "LBC Global Corporation," uses a type-written fill-in-the-blank format, and bears a notary stamp from Ronaldo Tugonon in a bolded, sans-serif font.[FN51] Meanwhile, both the certification of share ownership submitted in the Compliance and dated January 9, 2004 (the "Certification") and the May 2003 Resolution employ a fully-completed word-processed format, refer to the Delaware Holding Company as "PMHI Holdings Corporation (formerly LBC Global Corporation)," and carry a faded notary stamp from Tugonon in a serif typeface.[FN52] Perhaps most striking is that when confronted with these documents Araneta did not vehemently deny a charge of fabrication; instead, he claimed a convenient lack of memory.[FN53]

FN50. In his post-trial briefing, Araneta submitted the affidavit of Ronaldo Tugonon, the LBC in-house attorney who notarized each of the documents in question, which asserts that Tugonon maintained two offices and two notary stamps, and that his notary logs support the contemporaneous notarization of the May 2003 Resolution, rather than it being back-dated. Def. Post-Trial Br. Ex. 3. I do not consider this post-trial affidavit or its exhibits because it was submitted after the close of evidence at a time when ATR was unable to cross-examine Tugonon or test the merits of his affidavit. *See Stigliano v. Anchor Packing Co.*, 2006 WL 3026168, *1 (Del.Super.Ct.2006) (concluding that a post-deposition affidavit was hearsay and "not sufficiently trustworthy to allow its admission" when it had not been "tested by cross-examination"). I further note that the two-cities-two-stamps position Tugonon advances is hardly unassailable given that the "PTR" lines at the end of each notary stamp list the city of Pasay. *See* PX 59. Moreover, Tugonon's credibility is also suspect because he was likely involved, at the very least, in having Vicente sign documents in a capacity to which she was never properly appointed, which she did not understand, and which she never knowingly assumed.

FN51. PX 59.

FN52. *Id.*

FN53. Tr. at 142.

The timing of the May 2003 Resolution and the date of its appearance in this case also support ATR's claim of fabrication because this chronology establishes a motive for the creation of such a document. The May 2003 Resolution first appeared in the January 2004 Compliance-nearly six months after ATR's July 2003 demand letters put Araneta on notice of impending litigation and nearly three months after the § 220 action was filed-at a time when Araneta must

have realized that this court would not permit him to ignore ATR's demands. Moreover, when the May 2003 Resolution was produced in the Compliance, it was accompanied by balance sheets indicating that the removal of the LBC Operating Companies occurred between May 31, 2003 and December 31, 2003-after Araneta's purported resignation.[FN54] On that basis, Araneta asserted jurisdictional defenses and attempted to shift responsibility to Vicente.

FN54. *See* PX 54.

In light of all the evidence presented, it is possible that the May 2003 Resolution is a back-dated fabrication. Regardless, it is clear that none of the actual Delaware Holding Company directors stood behind it. Each continued to act as a Delaware Holding Company officer and director after that date. As important, it is undisputed that Vicente never accepted appointment to the Delaware Holding Company board and was not properly appointed at any board meeting, by any stockholder vote, or by any other recognized corporate procedure.[FN55] As such, I find the board of the Delaware Holding Company at all relevant times consisted of Araneta, Bonilla, and Berenguer. Consequently, I hold that as a factual matter Vicente was never a director of the Delaware Holding Company.

FN55. *See* Berenguer at 200-01 (confirming that the Delaware Holding Company did not have board meetings after January 2001, when its incorporation and funding were completed, and that there was never a formal meeting of the stockholders of the Delaware Holding Company at any time).

2. Araneta's Tax Defense

*10 Araneta's assertion that the Delaware Holding Company was never fully funded or operational is also one I reject as false. Araneta states that he never transferred the LBC Operating Companies to the Delaware Holding Company and that certain post-registration requirements necessary to commence business operations were never completed. As such, he contends that the plan to create and utilize the Delaware Holding Company to implement the Undertaking Agreement was abandoned in May 2000 as a result of certain adverse tax consequences of that proposal. But, these tax issues were resolved by December 2000-before the Delaware Holding Company was incorporated, before Araneta confirmed the Delaware Holding Company's ownership of the LBC Operating Companies, and before Araneta caused the Delaware Holding Company to file tax returns containing that same information.

Araneta bases his tax argument on the receipt of an opinion letter from a tax specialist that identified material tax obligations that would arise if the LBC Operating Companies were transferred into the Delaware Holding Company. That letter dated May 10, 2000 expressed the opinion that:

The proposal to make [LBC], a Philippine corporation, into a subsidiary of [the Delaware Holding Company] (a U.S. corporation) by an exchange of shares raises a number of concerns ... [because] corporations formed in the U.S. are taxed by the U.S. on their worldwide income, generally at a 34% or 35% rate on income above $100,000, though with limited crediting of the foreign tax they pay on foreign income.... On the other hand, the U.S. generally has no tax claim on the profits of non-US subsidiaries of non-US corporations.[FN56]

FN56. DX 21 at 4. Araneta also testified that he was informed that the initial transfer of assets into Delaware would create a tax liability in excess of $7.4 million. Tr. at 35 ("[T]here was a big mistake in incorporating-in putting assets in Delaware because of a very exorbitant or huge tax problem that my family or LBC was going to absorb. At some point, the amount ... was, in the tune of 7.4 to $8 million, rough estimates.").

As a result of these adverse tax consequences, Araneta testified that the Delaware Holding Company was abandoned as the implementation device and his focus shifted towards creating a holding company in Hong Kong.[FN57]

FN57. Tr. at 222.

ATR contends that any tax issue Araneta had with the

use of the Delaware Holding Company in the months surrounding May 2000 was resolved before the end of that year. Manuel Tordesillas, ATR's chief executive officer and one of the parties who signed the Undertaking Agreement, testified that he was not made aware of any tax issues that prevented the transfer of assets to the Delaware Holding Company until the start of this litigation.FN58 Further, because the Undertaking Agreement placed the responsibility on Araneta and LBC to organize and fund the Delaware Holding Company, Tordesillas explained that ATR was not involved in these implementation issues.FN59

FN58. Tr. at 289.

FN59. Tr. at 299-300, 383. This is unsurprising because the primary funding for the Delaware Holding Company was the transfer of assets controlled by Araneta, not ATR.

Moreover, by December 2000, ATR solicited and obtained Araneta's confirmation that he had incorporated and funded the Delaware Holding Company as part of ATR's negotiation of the sale of its 10% interest in the Delaware Holding Company to Philtread Tire & Rubber Company ("Philtread"). In connection with this sale, ATR informed Araneta of the need to complete the transactions required by the Undertaking Agreement. On December 8, 2000, Arnaiz emailed Araneta saying, "[T]o date, LBC is not in compliance with our agreement that requires LBC to set up a holding company incorporating under it all its subsidiaries." FN60 That same day, Araneta responded:

FN60. PX 7 at 2.

*11 PLEASE BE INFORMED THAT WE HAVE ALREADY INCORPORATED THE HOLDING COMPANY FOR YOUR ENTRY AS PER OUR PREVIOUS AGREEMENTS ..... WE HAVE ALSO RESOLVED WITH OUR TAX CONSULTANTS THE MANNER OF THE TRANSFER OF SOME ASSETS TO THE HOLDING CO[.], WE SHOULD WITHIN A WEEK OR TWO BE ABLE TO ISSUE IN THE NAME OF ATR [ITS] TEN PERCENT OWNERSHIP AND TOGETHER WITH IT THE STOCK CERTIFICATE CORRESPONDING TO THE TEN PERCENT.FN61

FN61. PX 7 at 1 (capitals and ellipses in original).

Three days later, on December 11, 2000, Araneta reiterated:

THE HOLDING COMPANY THAT WILL OWN THE "ARANETA" INTERESTS IN 100% LBC HOLDINGS USA, 100% LBC DEVELOPMENT AND 50% OF PROFESSIONAL MUTUAL HOLDINGS INC. IS LBC GLOBAL.... WE [ARE] REQUIRING LBC HOLDINGS USA AND LBC DEVELOPMENT TO ISSUE THE NECESSARY CERTIFICATES IN FAVOR OF LBC GLOBAL CORPORATION.FN62

FN62. PX 8 at 1.

These emails are devastating to Araneta's claims that tax problems forced the abandonment of the Delaware Holding Company in early-to-mid 2000 and that as a result of those alleged tax problems, no assets were ever transferred to the Delaware Holding Company. Rather than demonstrate a continuing reluctance or refusal to transfer assets, the emails indicate that by December 11, 2000, any tax problems relating to the transfer of the LBC Operating Companies to the Delaware Holding Company had been resolved such that Araneta was issuing the necessary certificates to effect this transfer.FN63

FN63. *See* PX 7, 8.

In addition to his December 2000 emails, Araneta personally confirmed that the Delaware Holding Company owned the LBC Operating Companies on two separate occasions in 2001. On January 22, 2001, Araneta signed a deed of adherence letter (the "Deed of Adherence") in both his personal capacity and as chairman of LBC Development attesting to the transfer of the LBC Operating Companies to the Delaware Holding Company.FN64 Six months later, on July 26, 2001, Araneta executed, in his personal capacity and on behalf of the Delaware Holding Company, a confirmation letter (the "Confirmation Letter") clari-

fying the Deed of Adherence and providing a balance sheet indicating that assets were owned by the Delaware Holding Company as of March 31, 2001.FN65

FN64. PX 20.

FN65. PX 27.

The Deed of Adherence explicitly confirmed the formation and funding of the Delaware Holding Company. It verified that:

[T]he holding company referred to as LBC HoldCo [the Delaware Holding Company] in the Undertaking Agreement has now been duly incorporated under the laws of the State of Delaware, U.S.A. and is named "LBC Global Corporation" which now owns, directly or indirectly, the Professional Holdings Shares, the Professional Holdings Advances, all the shares and interest in LBC and all the shares and interests in the companies and businesses which are owned and controlled by [Araneta], as follows:

(i) LBC Domestic Franchise Co., Inc. and its subsidiaries;

(ii) LBC Express, Inc. and its subsidiaries;

(iii) LBC Mabuhay Development Philippine Corporation and its subsidiaries;

(iv) LBC Holdings USA Corp. and its subsidiaries;

*12 (v) LBC International, Inc. and its subsidiaries (including all remittance businesses outside of LBC Holdings USA Corporation);

(vi) LBC Development Bank;

(vii) the foreign exchange business arising from the remittance transactions involving any and all of the above companies.FN66

FN66. PX 20 at 1-2.

Likewise, the Deed of Adherence included Araneta's consent to ATR's transfer of its interest in the Delaware Holding Company to Philtread and ATR's affiliation with Philtread going forward.

The drafting history of the Deed of Adherence reinforces Araneta's contemporaneous representations. Araneta originally agreed to provide the Deed of Adherence in the Undertaking Agreement, and confirmed that intention on January 9, 2001 in an email to ATR.FN67 He received an initial draft of the Deed of Adherence on January 10, 2001, and an electronic version the following day.FN68 Araneta and his attorneys revised the Deed of Adherence and sent it back to ATR for comments.FN69 ATR further revised the document to provide for ownership "directly or indirectly" of the assets by the Delaware Holding Company and to clarify language allowing the transfer of the assets to a Hong Kong entity only "provided, that all the assets ... shall *remain* owned and held by a single holding company, and that ATR shall in any event own and hold 10% of the capital stock of the same holding company." FN70 Neither Araneta nor his attorneys amended or renounced the claim that the LBC Operating Companies had, in fact, been transferred to the Delaware Holding Company, and Araneta executed the final version of the Deed of Adherence guaranteeing ATR's right to 10% of those assets.

FN67. Tr. at 170-71.

FN68. PX 15.

FN69. PX 18.

FN70. PX 19 at 1-2 (emphasis added).

The Confirmation Letter signed six months later reaffirmed the formation of the Delaware Holding Company and its ownership of the assets in both its text and in the balance sheet it incorporated as an attachment. The Confirmation Letter clearly stated:

As contemplated in the Undertaking Agreement and the [Deed of Adherence], LBC Global Corporation [i.e., the Delaware Holding Company] ... now owns directly or indirectly, the Professional Holdings Shares, the Professional Holdings Advances, all the shares and interest in LBC Development Corporation and the companies and businesses listed in the Undertaking Agreement which are owned and controlled by Mr. Carlos R. Araneta.FN71

FN71. PX 27 at 1.

Likewise, the balance sheet dated March 31, 2001 that was attached to the Confirmation Letter illustrated the Delaware Holding Company's recognition

of both its ownership of the LBC Operating Companies as assets and its pro rata liabilities to the Araneta family and ATR as described in the text of the letter.FN72 On the balance sheet, LBC Holdings USA, LBC Development, and Araneta's Professional Holdings shares are all listed under assets as "Investments" having a value of $36,235,500 at cost.FN73 Likewise, the balance sheet shows "Liabilities" of $39,220,000, represented as $3,922,000 "due to" ATR as well as a $35,298,000 "accounts payable" entry for the Araneta family.FN74 These "Liabilities" correspond exactly to the relative ownership of the Delaware Holding Company-10% to ATR and the remaining 90% to Araneta.

FN72. The Confirmation Letter explained the unique accounting methods used for the contribution of the assets. ATR and Araneta's contributions, although infusions of cash generating equity ownership interests, were recognized as liabilities due to the shareholders under a Philippine accounting practice. The Confirmation Letter clarified that the liabilities reflected on the balance sheet as a result of this transaction were payable pro rata based on percentage share ownership, much like dividends would be paid on equity. Specifically, the Confirmation Letter explained that "[a]ny conversion of all or any portion of the liabilities into equity shall be effected by LBC Global pro rata in proportion to the outstanding amount owed to each of the holders thereof," and "[a]ny full or partial payment or prepayment by LBC Global of the liabilities shall be made to all holders thereof pro rata in proportion to the amount owed to them respectively." PX 27 at 1-2.

FN73. *Id.* at Annex "A."

FN74. *Id.*

*13 In addition to Araneta's representations of the Delaware Holding Company's ownership of the assets, disclosures and financial statements by others affiliated with the Delaware Holding Company confirm that the corporation held controlling interests in the LBC Operating Companies from 2001 through 2003. Berenguer created a balance sheet identical to the one discussed above on July 19, 2001 in preparation for its inclusion in the Confirmation Letter.FN75 Victor Marquez, the Delaware Holding Company's accountant, distributed another copy of that very same balance sheet in the corporation's financial statements dated March 2001 and March 2002 FN76 and proffered it under the pains and penalties of perjury to the State of Delaware and the federal government as part of the corporation's tax returns filed for 2001 and 2002.FN77 In fact, no financial statement prepared between the balance sheet incorporated in the July 2001 Confirmation Letter-which Berenguer testified to have double checked before submitting FN78-and the balance sheet dated May 31, 2003 prepared by Araneta and submitted in connection with his Compliance in the § 220 action that preceded this dispute ever showed any combination of assets, liabilities, and equity inconsistent with the Delaware Holding Company's ownership of the LBC Operating Companies.

FN75. PX 23. Berenguer also testified to the Delaware Holding Company's ownership of the LBC Operating Companies on at least seven different occasions during her testimony. *See* Berenguer at 88-89, 155, 174, 177, 186, 201, 281.

FN76. *See* PX 25; PX 47.

FN77. *See* PX 41; PX 50.

FN78. Berenger testified that she was "double careful" in reviewing the figures on the balance sheet, and that she "cross-checked them against the letter" before she or Araneta signed off on them. Berenguer at 153-55.

On the basis of this contemporaneous record and as a predicate to my ultimate decision in this case, I conclude that the Delaware Holding Company owned the LBC Operating Companies. Correspondingly, I find that Araneta's testimony to the contrary was self-serving and untruthful.

3. *Araneta's Offset Defense*

Araneta's final defense is a semantic attempt to disguise the unfairness of his removal of the LBC Operating Companies. To explain the differences in the March 2003 and December 2003 balance sheets, Araneta testified that he had "offset" the roughly $36 million in assets he had removed from the Delaware Holding Company, i.e., the LBC Operating Companies, against the liability the Delaware Holding Company showed as "payable" to his family in the same amount. FN79 He maintains that the Delaware Holding Company is better off as a result of this transaction because of this decrease in its liabilities. FN80 But, Araneta still claims control over 90% of the equity in the Delaware Holding Company and never indicated that the assets had been transferred to any other holding company in which ATR would have a minority interest. FN81

FN79. When asked whether he had "offset the LBC assets-LBC Holdings and LBC Development-which added up to roughly 36 million ... against the Araneta advance liability that equaled the same 36 million," Araneta answered, "Yes. I think so, yes." Tr. at 253-54. Moreover, Araneta agreed that he "didn't consult with anyone when [he] did that." *Id.* at 254.

FN80. *Id.*

FN81. *Id.*

This "offset" defense does not withstand even minimal scrutiny. Despite the nomenclature on the financial statements, which characterize the contributions of the Advances and the LBC Operating Companies as "liabilities" rather than "equity," there is no dispute that the LBC Operating Companies were contributed in exchange for Araneta's 90% equity interest. Moreover, the Deed of Adherence and Confirmation Letter explain that any distributions out of the Delaware Holding Company would be paid pro rata on the majority and minority equity investments. No pro rata payment was made to ATR, and Araneta did not forfeit his equity position in the Delaware Holding Company when he cashed out the assets that he initially contributed. Thus, this scenario is even further removed than a non-pro rata exchange accompanying the retirement of the majority equity stake, which would liquidate one investor's stake and leave the remaining investor in complete control of the remaining assets. Here, the majority investor claims not to have given up his equity position even though it withdrew the entirety of its investment.

*14 It is illogical that ATR would be in a better position owning 10% of what had essentially become a shell corporation than it had been in while indirectly owning a share of the LBC Operating Companies. After the removal of the LBC Operating Companies, ATR's interest in the Delaware Holding Company was essentially a 10% stake in Araneta's minority position in the Pre-Need Company. FN82 If such a result were permitted to stand, it would unjustly enrich Araneta because after removing the same assets that he initially contributed he would have gained an indirect interest in the Pre-Need Company for nothing. That result is untenable, especially because ATR paid the costs of acquiring the Pre-Need Company out of its coffers in 1999. Thus, no legitimate offset could have taken place.

FN82. Tr. at 256-58.

Factually, then, Araneta's "offset" argument is without basis. Unlike some scenarios in which there may be a dispute as to the values given or received, this is a straightforward self-dealing case in which Araneta took something for nothing. His secretive conduct reinforces this point. FN83 Thus, I find the factual predicate for Araneta's "offset" argument has not been satisfied.

FN83. Araneta admitted that he alone decided to carry out this transaction without consulting with anyone, without notifying the other directors, and without informing ATR. Tr. at 254, 260.

E. *The Philippine Litigation Front*

After ATR filed its § 220 action in Delaware and was met with Araneta's first instance of litigation abuse, it was sued by Araneta in the Philippines. In that action, Araneta sought, among other relief, the annulment of

the Undertaking Agreement and Joint Venture Agreements on the grounds that ATR fraudulently concealed the implications, risks and consequences involved in the acquisition of the Pre-Need Company.FN84 In response, ATR sought a declaration of validity and judicial approval of the Colayco Sale.

FN84. Def. Post-Trial Br. Ex. 1 at 1. Jurisdiction for this contractual dispute was established in the Philippines based on forum selection clauses in both the Joint Venture Agreement and Undertaking Agreement providing: "Each of the parties irrevocably consents to the exclusive jurisdiction of the courts of the National Capital Judicial Region with respect to any action or proceeding relating to this Agreement." PX 1 at 5; DX 1 at 8.

In the end, Araneta lost his case in the Philippines decisively. The Regional Trial Court refused to annul any of the contracts between the parties. FN85 In upholding the validity of the Joint Venture Agreement and the Undertaking Agreement, the Regional Trial Court found that "there was no incident present in the case that would destroy the freedom of Araneta to enter in the agreements" and described Araneta's grounds for annulment to be "sham and contrived." FN86 It dismissed Araneta's complaint and entered judgment for ATR on January 24, 2006.

FN85. Def. Post-Trial Br. Ex. 1 at 4.

FN86. *Id.* at 3-4.

Following that decision, Araneta moved for reconsideration and ATR moved to enforce its rights under § 5 of the Undertaking Agreement, which granted ATR a put option whereby ATR could require Araneta to purchase its interest in the Delaware Holding Company. After reviewing the claims, on May 8, 2006, the Regional Trial Court reaffirmed the validity of the Undertaking Agreement and amended its previous decision to include the implementation of the provisions of § 5 of the Undertaking Agreement.FN87 As such, the court found Araneta "liable for the aggregate subscription or issue price of the [Delaware Holding Company] shares and the premium of 25% per annum." FN88 Araneta, of course, appealed that judgment. The parties indicate that the appellate process in the Philippines could take many years to complete.

FN87. Def. Post-Trial Br. Ex. 2 at 2.

FN88. *Id.* at 3.

III. *Legal Analysis*

*15 With this backdrop in mind, I begin my analysis with Araneta's suggestion that this court is not the proper forum for ATR's claims. I next turn to Araneta's disloyal conduct and false disclosures while serving as the dominant director and controlling stockholder of the Delaware Holding Company. Then, I focus on the other directors-Bonilla and Berenguer-and take up the questions regarding their responsibility to monitor Araneta's conduct. Finally, I address the appropriate relief to be awarded, including whether to grant ATR's request for an award of imposition of attorneys' fees and costs.

A. *Delaware Is The Proper Forum For ATR's Claims*

Araneta contends that the entirety of his dispute with ATR should have been resolved in the Philippines under the terms of the forum selection clauses of the Joint Venture Agreement and the Undertaking Agreement. But, in this court, ATR has premised its claims entirely on the fiduciary duties Araneta, Berenguer, and Bonilla owed to it as directors of a Delaware corporation, not on any other contractual duties that may exist between the parties. As such, this court may properly decide ATR's Delaware law claims.

Under the teaching of *Parfi Holding AB v. Mirror Image Internet, Inc.*, FN89 ATR was not required to press its Delaware law claims in the Philippines, as they do not "depend on the existence" of the Undertaking Agreement or Joint Venture Agreement for their viability.FN90 When sued by Araneta in the Philippines, ATR had no practical choice but to invoke its contractual remedies as defenses. By doing so, ATR did not waive claims it had against Araneta that are grounded in other legal and equitable duties Araneta owed to it that were not contractual in

nature.

FN89. 817 A.2d 149 (Del.2002).

FN90. *See id.* at 155-57 (explaining that "fiduciary duties ... consist of a set of rights and obligations that are independent of any contract" and can only be limited in their assertion by contractual provisions when "the claims based on fiduciary duties touch on the obligations created in the [contract]").

Here, ATR simply seeks to finish the process it began in July 2003, before Araneta filed his action in the Philippines, when it first began to pursue Araneta for breaching his duties as the director of a Delaware corporation. The existence of the Philippine litigation provides Araneta no defense. If he wished to escape this court's jurisdiction in responding to claims against him as a Delaware director, he needed to secure an explicit right to that effect. He did not do so and this court is available to ATR for it to seek redress as a stockholder of a Delaware corporation. Because ATR's claims alleging breaches of fiduciary duty by Araneta-as well as his co-directors Bonilla and Berenguer-arise independently of the parties' contracts, ATR does not seek an impermissible double recovery.

B. *Araneta Breached His Duty Of Loyalty By Stripping The Delaware Holding Company Of Its Major Assets For No Consideration*

ATR's allegations against Araneta are clear-cut claims of self-dealing by a controlling shareholder and director of a Delaware corporation. Araneta does not contest that he was the controlling shareholder of the Delaware Holding Company, and I have already found that his factual argument that he was not a director at all relevant times is without merit. Similarly, I have found as a fact that Araneta removed from the Delaware Holding Company its primary assets-its ownership of the LBC Operating Companies. In its financial statements and tax filings, the Delaware Holding Company had valued this ownership interest at over $36 million.FN91 Yet, by the end of 2003, this value had disappeared from the Delaware Holding Company's books. To where did Araneta remove the assets? To his family. What did the Delaware Holding Company receive in exchange? Effectively nothing. Araneta did not even reduce his 90% interest in the Delaware Holding Company when he repossessed the very assets that had secured that interest in the first place. Araneta simply took the LBC Operating Companies back in a fit of pique.

FN91. *See* Tr. at 254.

*16 The standard of review to evaluate this self-dealing is, of course, the entire fairness standard.FN92 As a director, Araneta had a duty of loyalty to the Delaware Holding Company to act in the best interests of the corporation and its shareholders and in a manner such that there would be "no conflict between [his] duty and [his] self-interest."FN93 Thus, as the director who conceived of and carried out the transfer of the LBC Operating Companies from the Delaware Holding Company to members of his family for no value, Araneta bore the burden of establishing the fairness of this transaction.FN94

FN92. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del.1983) ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.").

FN93. *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del.1939).

FN94. *See Chaffin v. GNI Group, Inc.*, 1999 WL 721569, at *5 (Del. Ch.1999) (finding that a father "must be deemed 'interested' in a transaction from which his child stood to benefit substantially in career and economic terms" and that "the entire fairness standard would apply").

Likewise, as the majority stockholder of the Delaware Holding Company, Araneta owed fiduciary duties to the minority shareholders of the corporation when dealing with the corporation's property.FN95 In this role, Araneta was prohibited from using his position of control to extract value from the corporation to the exclusion of, and detriment to, the minority stockholders.FN96 Consequently, in this capacity as

well, the law imposed upon Araneta the obligation to prove that the transfer he structured using his total dominion over the Delaware Holding Company's affairs was fair to the minority rather than an extraction of value to their detriment.[FN97] Araneta did not do that.[FN98]

FN95. *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 109-10 (Del.1952).

FN96. *See Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del.1971).

FN97. *See id.* at 721 (explaining that where a parent corporation "would be receiving something from [its] subsidiary to the exclusion of and detrimental to [the subsidiary's] minority stockholders" the combination of that "self-dealing, coupled with the parent's fiduciary duty, would make intrinsic fairness the proper standard").

FN98. This fraudulent transfer also involved a sale of substantially all of the Delaware Holding Company's assets and had to be performed consistently with 8 *Del. C.* § 271, which sets forth the procedures required to complete such a transaction. ATR has asserted, without contradiction from Araneta, that these procedures were not followed, and specifically that no shareholder vote took place. For his part, Araneta testified that he did not even inform ATR or his fellow directors about his removal of the LBC Operating Companies. Tr. at 254-55.

In this case, Araneta has not disputed these principles or even advanced an argument under the entire fairness rubric. Indeed, quite obviously, what Araneta did was not fair to the Delaware Holding Company or its minority stockholder, ATR. Araneta's only major defense is his factual claim that the assets were never transferred into the Delaware Holding Company. On this basis, Araneta asserts, without citation to any legal authority, that entire fairness review cannot attach to his transfer of the LBC Operating Companies. That is, Araneta rests his entire case on a factual claim which I reject.[FN99]

FN99. Because I reject the factual underpinning of Araneta's argument, I need not decide the legal issue he presents. But, I doubt that Delaware law would permit a fiduciary who contracted to convey assets to a corporation when soliciting a minority shareholder's investment and who later confirmed the corporation's ownership of those assets while serving as a director of that corporation to escape liability for redirecting those assets away from the corporation merely because the fiduciary "cut out the middleman" and never honored his obligation to place the assets into the corporation's accounts in the first place. Fiduciary duties do not attach only when assets are transferred but rather arise "where one person reposes special confidence in another, or where a special duty exists on the part of one person to protect the interests of another, or where there is a reposing of faith, confidence, and trust, and the placing of reliance by one person on the judgment and advice of another." *Lank v. Steiner*, 213 A.2d 848, 852 (Del. Ch.1965), *aff'd*, 224 A.2d 242 (Del.1966). From the moment Araneta became a director of, and ATR became a stockholder of, the Delaware Holding Company, Araneta had an obligation to enforce the Delaware Holding Company's right to ownership of the LBC Operating Companies for the benefit of the corporation and its shareholders that paralleled but existed independently from his contractual duty to cause the same transfer to occur. *See Legatski v. Bethany Forest Assoc., Inc.*, 2006 WL 1229689, at *6 (Del.Super.Ct.2006) (recognizing that contractual and fiduciary duties are not mutually exclusive).

That factual claim is ridiculous. Araneta asserts that for tax reasons he never did what he and his allies said he had done in numerous documents-including the corporation's tax filings!-that is, transfer control of the LBC Operating Companies to the Delaware Holding Company. Araneta says he was pondering using a Hong Kong company instead. But a written

agreement with ATR indicates that if Araneta wished to transfer the LBC Operating Companies to a Hong Kong entity, it could only do so on specific contractual terms. No evidence of such a transfer exists. Most important of all, it is preposterous to believe that ATR was willing to allow Araneta to keep the LBC Operating Companies for himself, rather than transferring them into some other corporation, whether located in the Philippines, Hong Kong, or elsewhere, in which ATR would have a 10% interest.

Recognizing that this claim might well be found ludicrous, Araneta and his counsel propounded an equally unpersuasive defense. They try to claim that the LBC Operating Companies were transferred to Araneta's family to extinguish a $36 million debt owed to the Aranetas by the Delaware Holding Company. On cross-examination, Araneta opined that the Delaware Holding Company was better off following the transaction because he "offset" these assets against a "liability" that the corporation owed to his family.[FN100]

FN100. Tr. at 256-57.

*17 Nothing in the record supports this position. The liability that Araneta purported to offset arose as a result of his contribution of the LBC Operating Companies and was valued based on Araneta's 90% ownership stake. But, following his so-called offset, Araneta testified that he maintained his 90% ownership.[FN101] Thus, ATR was left with a 10% stake in what is now effectively a shell corporation devoid of its primary operating assets, while Araneta and his family gained a windfall by retaining a 90% interest in the Delaware Holding Company's remaining assets-primarily the minority interest in the Pre-Need Company-without giving any substantial value in exchange. Suffice it to say that Araneta could not point to any fairness-enforcing procedures that he used to come up with this blatantly unfair transaction. Rather plainly, any director, officer, or advisor acting in good faith would have protested that the transaction was fraudulent.

FN101. Tr. at 258.

The evidence in this case is clear, and Araneta's attempts to distort that reality only make his conduct less tolerable. Araneta used his majority control and effective dominion over the Delaware Holding Company and its board of directors to engage in a course of unfair dealing that resulted in a de facto liquidation of corporate assets that enriched the Araneta family at the expense of the Delaware Holding Company and ATR.

C. *If The Delaware Holding Company Never Owned The LBC Operating Companies, Araneta Breached His Duty Of Loyalty By Knowingly Disclosing False Information*

In order to dispute his self-interested transfer of the LBC Operating Companies, Araneta testified that the Deed of Adherence and Confirmation Letter he signed and sent to ATR while he was a director of the Delaware Holding Company were false. These documents confirmed, both in express representations of fact and through financial statements showing the corporation's assets, that the Delaware Holding Company owned the LBC Operating Companies. But, Araneta testified at trial that he and ATR knew the ownership representations to be false at the time he signed the documents containing them. As I have explained, I find this "believe-me-now-I-was-lying-then" defense to be without merit. Yet, even if I were to accept the factual predicate to Araneta's argument, it would not aid Araneta in escaping liability.

As a corporate fiduciary, Araneta was required to be candid in all of his communications concerning the Delaware Holding Company's financial condition. As our Supreme Court explained in *Malone v. Brincat,* the fiduciary duty of loyalty prohibits a director from lying to the stockholders.[FN102] Thus, "[i]t necessarily follows from *Malone* that when directors communicate with stockholders, they must recognize their duty of loyalty to do so with honesty and fairness." FN103 As such, a stockholder may carry its burden by establishing that a director breached his or her "fiduciary duty of loyalty ... by knowingly disseminating to the stockholders false information about the financial condition of the company." [FN104]

FN102. 722 A.2d 5, 12 (Del.1998).

FN103. *Jackson Nat'l Life Ins. Co. v. Kennedy*, 741 A.2d 377, 390 (Del. Ch.1999).

FN104. *Malone*, 722 A.2d at 10.

*18 ATR has met its burden here. If Araneta's testimony in court is to be believed, he himself admits that his statements in the Deed of Adherence and in the Confirmation Letter were lies. Araneta testified: "The truth is, I signed these documents. And when I signed these documents they were not true. I signed these documents, but the assets were not transferred to Delaware." FN105 Moreover, Araneta confirmed that he understood that he was signing the Confirmation Letter "at the request of ATR for [the] Filipino Stock Exchange" and that he knew public shareholders would be seeing this information in some form.FN106 Thus, in Araneta's own words, neither the representations in the Deed of Adherence, the Confirmation Letter, nor the financial statements attached thereto provided an accurate picture of the Delaware Holding Company, and he knew it.

FN105. Tr. at 206-07.

FN106. Tr. at 200.

Araneta's defense to these admissions-that ATR should have known the falsity of the statements-is without merit. According to Araneta's tale, told for the first time at trial, Arnaiz pressured him to sign these documents and he gave in to that pressure to support his friend and to curry favor with the Philippine government because the brother of the Philippine President was involved with ATR.FN107 Although in Araneta's story ATR requested the letters, that fact does not establish that ATR knew the information therein to be untrue. Only Araneta's claim that he told Arnaiz that those statements were false purports to do that.FN108 Based on the ever-shifting positions taken by Araneta throughout this litigation, the conflict between his testimony on the witness stand and the contemporaneous emails he sent in December 2000, and the lack of any records indicating ATR's knowledge that the assets were not owned by the Delaware Holding Company after Araneta stated that the tax issues had been resolved, I do not credit Araneta's testimony.

FN107. Tr. at 42-47.

FN108. Araneta also argues that various communications sent to ATR regarding the purported tax and other hurdles to making the Delaware Holding Company operational between November 1999 and April 2000 provided notice to ATR that the assets had not been transferred to the Delaware Holding Company. *See* DX 5-21. But, the timing of these communications undercuts their value. Following these communications, Araneta sent an e-mail in December 2000 expressly stating that "WE HAVE ALSO RESOLVED WITH OUR TAX CONSULTANTS THE MANNER OF THE TRANSFER OF SOME ASSETS TO THE HOLDING CO." PX 7 at 1 (capitals in original). The only communication on this topic that Araneta sent after this date, an e-mail dated January 3, 2001, does not list anyone at ATR as a recipient. DX 22.

Consequently, I find that even if Araneta did not transfer the LBC Operating Companies to the Delaware Holding Company, he still violated his fiduciary duties to ATR on an alternate basis. Specifically, I hold that if the LBC Operating Companies were never owned by the Delaware Holding Company, Araneta breached his duty of loyalty to ATR by knowingly disclosing false information concerning the Delaware Holding Company, including false financial statements indicating its ownership of the LBC Operating Companies.FN109

FN109. Moreover, as a director of the Delaware Holding Company, Araneta had a duty to seek recourse against himself-odd, but true-if he failed to deliver the stock of the LBC Operating Companies to the Delaware Holding Company. Of course, I find that his breach occurred later, when he stripped the Delaware Holding Company of those Companies' stock. But either way, Araneta breached his fiduciary duties.

ATR has also brought a fraud claim against Araneta. Given that this claim is identical to ATR's *Malone*

claim but would arguably involve more stringent standards,[FN110] and because I have already found that the transfer occurred and was substantially unfair, I need not reach it. Insofar as reasonable reliance is required, ATR has shown that after being informed that the Delaware Holding Company owned the LBC Operating Companies, it acted on that information.

> FN110. Delaware's standards of fiduciary disclosure are specialized applications of fraud standards. As a result, a plaintiff is rarely better off pressing garden-variety common law fraud claims when a more tailored fiduciary disclosure claim can be pursued. *See Metro Communication Corp. BVI v. Advanced Mobilecomm Technologies Inc.*, 854 A.2d 121, 156 (Del.Ch.2004) ("[T]he standards that a fiduciary faces are tougher than the common law and equitable fraud standards, which always require proof of reasonable reliance.").

In a transaction that closed in November 2001, ATR sold its 10% interest in the Delaware Holding Company to Philtread, reinvesting the entire proceeds of the sale as well as roughly $1.2 million in additional capital back into Philtread to create an Internet service and fulfillment business. ATR intended to use the LBC Operating Companies as part of the fulfillment side of its business model for Philtread. More importantly, because Philtread was publicly listed on the Philippine Stock Exchange, ATR made representations to the Philippine equivalent of the U.S. Securities and Exchange Commission and to outside investors that the Delaware Holding Company was "the ultimate holding company for all the LBC operations," including the LBC Operating Companies, among others, based on Araneta's express confirmation of those facts in the Deed of Adherence and Confirmation Letter he signed while a director of the Delaware Holding Company.[FN111] As such, to the extent that ATR cannot hold Araneta accountable by receiving a remedy for his actions in never giving up ownership of the LBC Operating Companies, ATR has exposed itself to liability by endorsing and disseminating Araneta's false statements.

> FN111. PX 32 at 33 (describing the Delaware Holding Company in Philtread's public disclosures); *see also* PX 20 (Deed of Adherence); PX 27 (Confirmation Letter) (containing Araneta's express representations).

*19 Of course, I ultimately conclude that Araneta did originally hand over the LBC Operating Companies to the Delaware Holding Company and that the Delaware Holding Company did own those assets for over two years-from at least January 22, 2001, when Araneta attested to that fact in the Deed of Adherence, to May 31, 2003, the date of the last balance sheet showing ownership of those assets-before Araneta stripped them away for no value. But, either way, Araneta has caused harm to ATR.

D. *Bonilla And Berenguer Acted As Stooges For Araneta And Failed To Take Any Steps To Perform Their Duties As Fiduciaries*

I now come to a slightly more difficult issue. Namely, to what extent should Araneta's fellow directors, Bonilla and Berenguer, share responsibility for harming the Delaware Holding Company and ATR?

Making this more challenging is that ATR does not allege that either Berenguer or Bonilla participated in, approved of, or directly profited from Araneta's removal of the LBC Operating Companies. Rather, ATR claims that Bonilla and Berenguer consciously breached the important duties articulated in this court's *Caremark*[FN112] decision and recently reaffirmed by our Supreme Court in *Stone v. Ritter*.[FN113] Specifically, ATR alleges that Bonilla and Berenguer failed to monitor Araneta's conduct thereby allowing his self-dealing to continue.

> FN112. *In re Caremark Int'l, Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch.1996).
>
> FN113. 911 A.2d 362, 2006 WL 3169168 (Del.2006).

Under Delaware law, it is fundamental that a director cannot act loyally towards the corporation unless she tries-i.e., makes a genuine, good faith effort-to do her job as a director.[FN114] One cannot accept the im-

portant role of director in a Delaware corporation and thereafter consciously avoid any attempt to carry out one's duties.

FN114. *See Guttman v. Huang*, 823 A.2d 492, 506 & n. 34 (Del. Ch.2003).

One of the most important duties of a corporate director is to monitor the potential that others within the organization will violate their duties. Thus, "a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists." FN115 Obviously, such a reporting system will not remove the possibility of illegal or improper acts, but it is the directors' charge to "exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary questions, so that it may satisfy its responsibility." FN116 Thus, as the Supreme Court recently stated:

FN115. *Caremark*, 698 A.2d at 970.

FN116. *Id.*

Caremark articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith. FN117

FN117. *Stone*, 911 A.2d 362, 2006 WL 3169168, at *17.

***20** From the testimony of the directors of the Delaware Holding Company, it is apparent that no reporting system was in place and that no other information systems or controls were ever considered, let alone implemented, by the Delaware Holding Company's board of directors. They did not even have regular board meetings. As a result, the directors were often unaware of corporate activities-despite how easy that would have been given the Delaware Holding Company's modest size. Berenguer testified that although there had been meetings regarding the Delaware Holding Company before the LBC Operating Companies were transferred into the corporation in January 2001, she did not remember any meetings of the board of directors or of the shareholders after that time. FN118 Bonilla confirmed this fact, explaining that when the Delaware Holding Company's name was changed from LBC Global, Corp. to PMHI Holdings, Corp., he was never informed about the change, never voted to approve it, and did not even know what the initials PMHI in the new corporate name stood for at the time he signed the certificate of amendment as the corporation's authorized agent. FN119 Even when corporate activities involved them directly-as in the case of their supposed resignations from the board of directors-neither Berenguer nor Bonilla questioned the wisdom of Araneta's actions nor insisted that corporate procedures be followed. FN120

FN118. Berenguer at 201.

FN119. Bonilla I at 175-76; *see also* PX 54 at 6-7.

FN120. Notwithstanding the issues regarding the date of their resignation as directors, the process by which Berenguer and Bonilla were removed by Araneta is telling. Bonilla testified that he received a phone call from Araneta informing them that he was no longer a director of the Delaware Holding Company. Bonilla I at 47. Berenguer explained that she did not give formal written notice of her resignation; instead, Araneta just "took it [she] wanted to resign" from the Delaware Holding Company based on her general "verbal intention" to "resign in all LBC" and eventually "replaced" her. Berenguer at 83-84, 195.

Moreover, both Berenguer and Bonilla testified that they entirely deferred to Araneta in matters relating to the Delaware Holding Company. Berenguer is, as mentioned, Araneta's niece and served as the CFO for the LBC group of companies worldwide.[FN121] She testified that she would not insert herself into a disagreement between ATR and Araneta about how the Delaware Holding Company should proceed on an issue because such a disagreement would be between those parties and would not affect her as a director of the Delaware Holding Company.[FN122] Similarly, she stated that she would take Araneta's word as authoritative if he claimed that he had agreed with ATR to take certain actions.[FN123] Bonilla, the head of Araneta's U.S. operations, was more explicit-explaining that to him Araneta and the Delaware Holding Company were basically one and the same and that he took the word of Araneta as being the word of the company.[FN124] Moreover, when pressed regarding whether he would undertake an independent inquiry if told to act by Araneta, Bonilla responded, "Why should I ask him all these questions? He's telling me they have already agreed .... It's not like I'm going to go out there and check on him, doesn't make sense."[FN125]

FN121. Berenguer at 47-48.

FN122. Berenguer at 68.

FN123. Berenguer at 197.

FN124. Bonilla I at 63.

FN125. Bonilla I at 180-81.

Based on these failures, neither Berenguer nor Bonilla can be said to have upheld their fiduciary obligations. Although it was Araneta who ran amok by emptying the Delaware Holding Company of its major assets, the other directors did nothing to make themselves aware of this blatant misconduct or to stop it.

*21 Put in plain terms, it is no safe harbor to claim that one was a paid stooge for a controlling stockholder. Berenguer and Bonilla voluntarily assumed the fiduciary roles of directors of the Delaware Holding Company. For them to say that they never bothered to check whether the Delaware Holding Company retained its primary assets and never took any steps to recover the LBC Operating Companies once they realized that those assets were gone is not a defense. To the contrary, it is a confession that they consciously abandoned any attempt to perform their duties independently and impartially, as they were required to do by law. Their behavior was not the product of a lapse in attention or judgment; it was the product of a willingness to serve the needs of their employer, Araneta, even when that meant intentionally abandoning the important obligations they had taken on to the Delaware Holding Company and its minority stockholder, ATR.

When required by their office to be loyal to the Delaware Holding Company, Bonilla and Berenguer chose total fealty to Araneta's conflicting interests instead. Consequently, I find them jointly liable for Araneta's fiduciary violations.

E. *The Core Remedy*

The major breach of fiduciary duty in this case is one that injured the Delaware Holding Company in the first instance and ATR secondarily as a minority stockholder. The obvious remedy for this wrongdoing would be to require Araneta to return control of the LBC Operating Companies to the Delaware Holding Company.

ATR is practical, however. It recognizes that it would likely take years and years to chase Araneta and his family around the nation (Araneta has a house in California) and across the globe to get that type of order implemented. Thus, ATR is willing to forsake a full remedy (in the sense that it appears the LBC Operating Companies have done very well) and to accept a direct award of damages.

A direct award to ATR is justified here. Araneta's behavior worked a de facto liquidation of the Delaware Holding Company. It would be unreal to require a monetary award to the Delaware Holding Company by Araneta and his blindly subservient subordinates, Bonilla and Berenguer. Even if such a payment were made, it would be foolhardy to believe that Araneta and his servants could be trusted to allow ATR to be-

nefit from the grant of that relief to the Delaware Holding Company.

Rather, because Araneta's conduct had the effect of liquidating the Delaware Holding Company, it is appropriate to premise relief on the need to make ATR whole for the injury it suffered by entrusting its capital to the Delaware Holding Company, only to see that corporation impoverished by the defendants. The best way to shape that award is to require Araneta and the defendants to pay back to ATR the cost of acquiring its equity in the Delaware Holding Company-$3.922 million-plus pre-judgment interest at a rate that fairly compensates ATR for its loss of the upside inherent in the LBC Operating Companies' profit and growth. In determining that rate, I am aided by the parties' dealings and Araneta's admittedly high cost of debt and equity capital. Araneta's cost of debt was as high as 18%.[FN126] This high (equity-level) rate supports the fairness of a very high rate of interest, as it suggests an even higher cost of equity. That conclusion is confirmed by § 5 of the Undertaking Agreement. In that section, ATR secured a put option at a premium of 25% per annum over the issue price of ATR's shares in the Delaware Holding Company if exercised after the first two years of the investment. Using this contractual estimate of Araneta's cost of equity is the best way to do justice, even though it likely still leaves Araneta with a windfall.[FN127] I will compound this interest rate monthly in accordance with my understanding of prevailing commercial practices and in order to better ensure that ATR is made whole.[FN128]

FN126. *See* Bonilla II at 44-45 (confirming that LBC's cost of private debt is 15%-18%).

FN127. *See* Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A.2d 160, 175 (Del.2002) (permitting the Court of Chancery to fashion "broad, discretionary, and equitable remedies" in cases involving a breach of the duty of loyalty); Int'l Telecharge, Inc. v. Bomarko, Inc., 766 A.2d 437, 440 (Del.2000) ("[T]he powers of the Court of Chancery are very broad in fashioning equitable and monetary relief under the entire fairness standard as may be appropriate."); Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del.1983) (holding that when the entire fairness standard is not met, the Court of Chancery's "powers are complete to fashion any form of equitable and monetary relief as may be appropriate"). In fashioning a remedy, I err on the side of generosity to the plaintiffs because "Delaware law dictates that the scope of recovery for a breach of the duty of loyalty is not to be determined narrowly" and because "strict imposition of penalties under Delaware law are designed to discourage disloyalty." Bomarko, 766 A.2d at 441 (quoting Thorpe by Castleman v. CERBCO, Inc., 676 A.2d 436, 445 (Del.1996)); *see also* Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 855 A.2d 1059, n. 20 (Del. Ch.2003).

FN128. *See* Brandin v. Gottlieb, 2000 WL 1005954, at *29 (Del. Ch.2000) (explaining that this court has "broad discretion, subject to principles of fairness, in fixing the rate [of interest] to be applied"); Gotham Partners, 817 A.2d at 173 (finding that the Court of Chancery's "uncontested 'discretion to select a rate of interest higher than the statutory rate ... include[s] the lesser authority to award compounding.' "); *see also* Henke v. Trilithic, Inc., 2005 WL 2899677, at *13 (Del. Ch.2005) (explaining that awarding interest compounded on a monthly basis because doing so better "comports with the fundamental economic reality" that investors and "companies neither borrow nor lend at simple interest rates"); Smith v. Nu-West Indus., 2001 WL 50206, at *1 (Del. Ch.2001) (awarding interest compounded monthly), *aff'd*, 781 A.2d 695 (Del.2001).

***22** It is worth noting that ATR requested monthly compounding in their opening brief. The defendants did not respond to this request except insofar as they argued that no damage award of any amount should be entered. Suffice it to say, the defendants are therefore in no position to quibble about the interest rate I now award, having forsaken their chance to respond.

All of the defendants will be jointly and severally liable for the amount of the judgment. Nonetheless, I find that in any action as between Araneta, on the one hand, and Bonilla and Berenguer, on the other, Araneta should be deemed responsible to pay the entire judgment. In other words, to the extent it is later important, if Bonilla and Berenguer pay any or all of the judgment, Araneta should be required to make them whole, to the extent that is consistent with applicable law.FN129

FN129. In qualifying this statement, I simply recognize that when persons act as mere tools for malefactors and contribute to harm to others, public policy might limit their ability to seek indemnification from their "boss," so to speak. That might be an occupational hazard.

F. *Attorneys' Fees*

Finally, I consider ATR's request for an award of attorneys' fees. Delaware follows the American Rule under which parties to litigation normally bear their own costs regardless of the outcome of their case.FN130 Yet, the American Rule, and correspondingly Delaware's application thereof, provide for fee awards in exceptional circumstances in order to deter abusive litigation, avoid harassment, and protect the integrity of the judicial process.FN131 These circumstances include fraud, bad faith, or other outrageous conduct from which the claim arose and bad faith behavior in the course of subsequent litigation. FN132 Here, ATR claims that the egregious nature of Araneta's fiduciary breaches coupled with the implausibility of his defenses and his bad faith in defending this litigation necessitate a fee-shifting award. I agree.

FN130. *Johnston v. Arbitrium (Cayman Islands) Handels*, 720 A.2d 542, 545-46 (Del.1998); *see also* John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 AM. U.L. REV. 1567 (1993) (contrasting the American Rule with the English Rule whereby the losing party must pay the victor's litigation expenses).

FN131. *Kaung v. Cole National Corp.*, 884 A.2d 500, 506 (Del.2005).

FN132. *See Gans v. MDR Liquidating Corp.*, 1998 WL 294006, at *3 (Del. Ch.1998) ("Delaware courts have recognized the following as meriting an award of fees: (i) statutory authority; (ii) a class representative's litigation costs on behalf of the class; (iii) bad faith conduct in litigation; and (iv) fraud, bad faith, or other outrageous conduct from which the claim arose.").

The U.S. Supreme Court has explained that "bad faith may be found, not only in the actions that led to the lawsuit, but also in the conduct of the litigation." FN133 Delaware courts have awarded attorneys' fees when defendants "had no valid defense and knew it," when "they unnecessarily required the institution of litigation, delayed the litigation, asserted frivolous motions, falsified evidence and changed their testimony to suit their needs," and when, in short, they "constructed their entire defense in bad faith." FN134 Although any one of these findings alone would be sufficient to justify a shifting of fees; in this case, there is ample evidence to establish transgressions in each of these categories by Araneta.

FN133. *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 766 (1980) (citations and quotations omitted).

FN134. *Arbitrium (Cayman Islands) Handels*, 702 A.2d at 546; *see also Jacobson v. Dryson Acceptance Corp.*, 2002 WL 31521109, at *16 (Del. Ch.2002) (stating that fee awards "may be appropriate where a party misleads the court, alters his testimony or changes his position."), *aff'd*, 826 A.2d 298 (Del.2003).

Here, Araneta's bad faith was pervasive. Araneta's basic duties as a fiduciary of the Delaware Holding Company were well-established. But, by transferring the LBC Operating Companies from the Delaware Holding Company to his family for no value, Araneta flouted his obligations to the minority shareholders and profited at their expense. Moreover, when served

with the § 220 suit, this lawsuit, and confronted with his conduct, Araneta engaged in a deliberate pattern of obfuscation ranging from the obstruction of legitimate discovery requests, to the presentation of baseless and shifting defenses, and ultimately to the telling of outright lies under oath and the submission of a phony defense in an attempt to escape this court's jurisdiction by exposing his own secretary to legal risk on the pretense that she was the sole director of the Delaware Holding Company during the period when Araneta denuded it of the LBC Operating Companies.FN135

FN135. *See H & H Brand Farms, Inc. v. Simpler*, 1994 WL 374308, at *5-6 (Del. Ch. June 10, 1994) (imposing fee award for "acts of bad faith and wanton disregard for the rights of others").

*23 Certainly, not all breaches of the fiduciary duty of loyalty warrant the imposition of attorneys' fees.FN136 But, where an "untenable conflict should have been perfectly obvious," a director's "effrontery in going forward nonetheless is reprehensible" and those "seeking to censor this outrageous conduct should have their attorneys' fees paid." FN137 Thus, as an initial matter, I may award fees if I find that Araneta's conduct giving rise to this litigation constituted "an egregious breach" of his duty to ATR. FN138 His conduct involved such an egregious breach. It was a fraudulent transfer that Araneta sought, by later fraud, to conceal.

FN136. *See, e.g., Weinberger v. UOP, Inc.*, 517 A.2d 653, 656 (Del. Ch.1986) (refusing to award fees for breach of fiduciary duty absent unjustifiable or bad faith conduct).

FN137. *Gans*, 1998 WL 294006, at *4.

FN138. *Id.*

Likewise, Araneta's misconduct during the litigation process was extensive. He obstructed legitimate requests for discovery. He proffered false testimony in order to avoid this court's jurisdiction and liability. In sum, he made the procession of the case unduly complicated and expensive.

Chancellor Allen well captured the traditional reluctance of this court to shift fees under the bad faith exception to the American Rule, by stating that the bad faith exception only applied when the party in question displayed "unusually deplorable behavior." FN139 Even under that standard, which is more stringent than that articulated recently by our Supreme Court in *Kaung v. Cole National Corp.*,FN140 Araneta easily qualifies for an order requiring him to pay ATR's attorneys' fees and expenses. Because of Araneta's bad faith, I also will enter an order requiring him to bear any additional attorneys' fees and expenses ATR is forced to bear in seeking to collect on this judgment. This will ensure that ATR obtains full relief if it is forced to expend even more resources to obtain redress from Araneta.

FN139. *Barrows v. Bowen*, 1994 WL 514868, at *2 (Del. Ch.1994).

FN140. 884 A.2d 500, 506 (Del.2005).

On this score, however, Bonilla and Berenguer are in a different position than Araneta. Their regrettable, if all too historically traditional, role as instruments of a controller's will rightly exposes them to damages liability, but they have not engaged in conduct that satisfies the exacting bad faith standard required for fee shifting.

IV. *Conclusion*

Based on the foregoing, I find in favor of ATR on each of its claims and award ATR $3,922,000 in damages plus pre-judgment as well as post-judgment interest on this amount. Pre-judgment interest shall accrue at an annual rate of 25% with monthly compounding from the date of ATR's investment in the Delaware Holding Company through the date a final judgment is entered. Post-judgment interest at the statutory rate will accrue thereafter until payment is made. Araneta shall also pay ATR's attorneys' fees, costs, and expenses incurred in prosecuting this action and shall pay any future costs expended by ATR in enforcing this judgment. Counsel for the parties shall craft a final order implementing this decision within 20 days.

Del.Ch.,2006.

ATR-Kim Eng Financial Corp. v. Araneta
Not Reported in A.2d, 2006 WL 3783520 (Del.Ch.)

END OF DOCUMENT

GRANTED

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

ATR-KIM ENG FINANCIAL CORPORATION, and ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, v. CARLOS R. ARANETA, HUGO BONILLA, LIZA BERENGUER AND MARITES VICENTE, Defendants, and PMHI HOLDINGS CORPORATION, (f/k/a LBC GLOBAL CORPORATION), a Delaware corporation, Nominal Defendant.	Civil Action No. 489-N

FINAL ORDER OF JUDGMENT

For the reasons set forth in the December 21, 2006 post-trial Memorandum Opinion in the captioned matter, which found in favor of plaintiffs (collectively "ATR") on each fiduciary claim asserted, IT IS HEREBY ORDERED as follows:

1. Having been found jointly and severally liable for their breaches of fiduciary duty, judgment is entered against defendants Carlos R. Araneta, Hugo Bonilla and Liza Berenguer in the amount of $24,490,422.50 (representing a damages award of $3.922 million plus pre-judgment interest from August 17, 1999 through January 10, 2007 at an annual rate of 25% compounded monthly).

2. In light of his egregious misconduct both before and during the litigation of this matter, judgment is also entered against defendant Carlos R. Araneta in the additional amount of $863,059.89 (representing an award of the attorneys' fees, costs and expenses ATR incurred in prosecuting this action).

3. Post-judgment interest on these awards shall accrue at an annual rate of 11.25%, and judgment is entered against the defendants for all such interest that accrues between the date of this Order and the date on which they make full payment of the amounts due hereunder. Carlos R. Araneta is also ordered to pay all future fees, costs and expenses incurred by ATR in enforcing this Order.

/s/ Leo E. Strine, Jr.
Leo E. Strine, Jr.,
Vice Chancellor

Dated: January 10, 2007

FILED
PROTHONOTARY
2007 JAN 11 AM 10:55

CERTIFIED
AS A TRUE COPY:
ATTEST:
REGISTER IN CHANCERY
By

Court: DE Court of Chancery

Judge: Strine, Leo E

File & Serve reviewed Transaction ID: 13408130

Current date: 1/10/2007

Case number: 489-N

Case name: A T R Kim Eng Financial Corp et al vs Carlos R Araneta et al

/s/ Judge Leo E Strine Jr

EFiled: Jun 14 2007 10:35AM EDT
Filing ID 15225238
Case Number 60,2007

IN THE SUPREME COURT OF THE STATE OF DELAWARE

CARLOS R. ARANETA, HUGO BONILLA and LIZA BERENGUER,	§	No. 60, 2007
Defendants Below, Appellants,	§	Court Below—Court of Chancery of the State of Delaware, in and for New Castle County
v.	§	C.A. No. 489
ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC.,	§	
Plaintiffs Below, Appellees.	§	

Submitted: June 13, 2007
Decided: June 14, 2007

Before **HOLLAND, BERGER** and **JACOBS**, Justices.

This 14th of June 2007, the Court having considered this matter after briefing and oral argument, has determined the appeal is without merit because: to the extent the issues raised on appeal are factual, the record evidence supports the trial judge's factual findings; to the extent the errors alleged on appeal are attributed to an abuse of discretion, the record does not support those assertions; and to the extent that the issues raised on appeal are legal, they are controlled by settled Delaware law, which was properly applied. Therefore, this Court has concluded that the final judgment of the

Court of Chancery should be affirmed on the basis of and for the reasons assigned by the Court of Chancery in its decision dated December 21, 2006.

NOW, THEREFORE, IT IS HEREBY ORDERED that the final judgment of the Court of Chancery, entered on January 10, 2007, is, AFFIRMED.

BY THE COURT:

Justice

RECORDING REQUESTED BY AND
WHEN RECORDED MAIL TO:

MONICA ARANETA
1605 WEDGEWOOD DRIVE
HILLSBOROUGH, CA 94010

MAIL TAX STATEMENTS TO:

MONICA ARANETA
1605 WEDGEWOOD DRIVE
HILLSBOROUGH, CA 94010

APN: 038-074-010

2007-003707
02:14pm 01/09/07 DE Fee: 30.00
Count of pages 2
Recorded in Official Records
County of San Mateo
Warren Slocum
Assessor-County Clerk-Recorder

* 2 0 0 7 0 0 0 3 7 0 7 A R *

(SPACE ABOVE THIS LINE FOR RECORDER'S USE)

GRANT DEED

THE UNDERSIGNED GRANTOR(S) DECLARE(S) Consideration less than $100
DOCUMENTARY TRANSFER TAX IS $ -0-

FOR VALUABLE CONSIDERATION, the receipt and sufficiency of which is hereby acknowledged, HUGO BONILLA, a married man, as his sole and separate property, hereby GRANT(S) to MONICA ARANETA, the real property commonly known as 1605 Wedgewood Drive, Hillsborough, County of San Mateo, State of California, and more particularly described as follows:

See Exhibit "A" attached hereto and incorporated herein by this reference.

Dated: 1-8-2007

Hugo Bonilla

STATE OF CALIFORNIA)
) ss.
COUNTY OF SAN MATEO)

On this 8 day of January in the year 2007, before me, Victoria Rodrigues, a Notary Public in and for said State, personally appeared Hugo Bonilla, personally known to me (or proved on the basis of satisfactory evidence) to be the person(s) whose name is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies) and that by his/her/their signature(s) on the instrument the person(s), or the entity(ies) upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

VICTORIA RODRIGUES
Commission # 1417957
Notary Public - California
San Mateo County
My Comm. Expires Jun 12, 2007

Victoria Rodrigues
NOTARY PUBLIC IN AND FOR SAID STATE

FOR NOTARY SEAL OR STAMP

MAIL TAX STATEMENTS AS DIRECTED ABOVE

EXHIBIT
2
Bonilla 3/7/07

EXHIBIT "A"

Description:

The land referred to herein is situated in the State of California, County of San Mateo, Town of Hillsborough, and is described as follows:

LOT 9, AS SHOWN ON THAT CERTAIN MAP ENTITLED, "CRYSTAL SPRINGS MAP NO. 1-A, HILLSBOROUGH, SAN MATEO COUNTY, CALIFORNIA", FILED IN THE OFFICE OF THE RECORDER OF THE COUNTY OF SAN MATEO, STATE OF CALIFORNIA, ON AUGUST 15, 1947, IN BOOK 27 OF MAPS AT PAGE(S) 45, 46, 47 AND 48.

AP No.: 038-074-010 JPN: 038-007-074-01

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Message-Id:<6461053@canb.uscourts.gov>
Subject:07-03079 Complaint

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U.S. Bankruptcy Court

Northern District of California

Notice of Electronic Filing

The following transaction was received from Lafferty, William entered on 7/23/2007 at 5:14 PM PDT and filed on 7/23/2007

Case Name: ATR-Kim Eng Capital Partners, Inc. et al v. Bonilla
Case Number: 07-03079
Document Number: 1
Case Name: Hugo Nery Bonilla
Case Number: 07-30309
Document Number: 76

Docket Text:
Adversary case 07-03079. 41 (Objection / revocation of discharge - 727(c),(d),(e)), 67 (Dischargeability - 523(a)(4), fraud as fiduciary, embezzlement, larceny) Complaint by ATR-Kim Eng Capital Partners, Inc., ATR-Kim Eng Financial Corporation against Hugo Nery Bonilla. Fee Amount $250. (Attachments: # (1) Exhibit A# (2) Exhibit B# (3) Exhibit C# (4) Exhibit D) (Lafferty, William)

The following document(s) are associated with this transaction:

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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In Re: HUGO NERY BONILLA, Debtor.	Case No. 07-30309 Chapter 7 Adv. Proc. No. 07-03079
ATR-KIM ENG FINANCIAL CORPORATION AND ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	Date: September 28, 2007 Time: 9:30 a.m. Place: 235 Pine Street Courtroom No. 23 San Francisco, CA (Judge Carlson)

MEMORANDUM OF POINTS AND AUTHORITIES SUPPORTING MOTION TO DISMISS COMPLAINT

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I. INTRODUCTION

Defendant Hugo Nery Bonilla, debtor in the within bankruptcy case, hereby moves to dismiss the fourth claim for relief set forth in the Complaint filed by ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. (collectively, "ATR"). ATR's fourth claim alleges that its judgment against Bonilla in the matter titled *ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. v. Carlos R. Araneta, et al.*, Delaware Court of Chancery No. ICV.A. 489-A ("the Delaware Judgment"), and which holds Bonilla jointly and severally for damages in the amount of $24,981,069.66, is non-dischargeable under Bankruptcy Code Section 523(a)(4).

Dismissal of the fourth claim is proper because ATR fails to state a claim upon which relief may be granted under Section 523(a)(4). ATR alleges that many of the factual findings relevant to its claims are set forth in the Delaware Chancery Court's Memorandum Opinion, which is attached as Exhibit A to ATR's complaint. But the Memorandum Opinion does not set forth findings, and ATR's complaint does not set forth allegations, which support the elements required in order to establish that Bonilla's debt to ATR is non-dischargeable under Section 523(a)(4). First, the Delaware Chancery Court did not find that Bonilla was a fiduciary to ATR pursuant to an express or statutory trust under Delaware state law. Rather, the Delaware Chancery Court found that as a corporate director, Bonilla breached his fiduciary duties to shareholder ATR. But Bonilla's duties to ATR as a corporate director fall within the realm of the broad and general definition of a fiduciary, which is inapplicable to the dischargeability context and are not sufficient to support a Section 523(a)(4) claim.

Second, the Delaware Chancery Court did not find and ATR does not allege in its complaint that Bonilla intentionally deceived ATR. Thus, ATR does not state facts sufficient to support its allegation that Bonilla committed "fraud while acting in a fiduciary duty." Consequently, dismissal is proper because ATR alleges no facts to support a Section 523(a)(4) claim.

II. THE DELAWARE JUDGMENT

On December 21, 2006, the Delaware Chancery Court issued its Memorandum Opinion, in ATR's suit against Bonilla and other defendants. Compl. at Ex. A. The Delaware Chancery Court

dedicated most of its decision to ATR's claims against Bonilla's co-defendant Carlos Araneta. The findings and rulings pertaining to ATR's claims against Bonilla are as follows:

A. Findings Regarding The Incorporation Of The Delaware Holding Company

Defendant Araneta is a Philippine business man who owns and operates his family's business, which consist of numerous courier and money remittance companies run from the Philippines. Compl. at Ex. A, p. 3. Araneta's companies all share the initials "LBC" in their names (collectively, "LBC Operating Companies"). Compl. at Ex. A, p. 3.

In 1999, ATR and Araneta entered into two contracts with each other. Compl. at Ex. A, p. 3. In the first, titled the "Joint Venture Agreement", ATR and Araneta agreed to purchase a controlling interest in The Professional Group Plans, Inc. ("the Pre-Need Company"), and ATR agreed to advance $3.922 million on Araneta's behalf. Compl. at Ex. A, p. 3. In the second, titled the "Undertaking Agreement", Araneta pledged "to contribute the LBC Operating Companies along with his newly acquired interest in the Pre-Need Company to a new holding company and to issue to ATR a 10% minority interest in that entity." Compl. at Ex. A, p. 3. The Undertaking Agreement protected ATR's investment in the LBC Operating Companies by granting ATR a right to a seat on the board of directors of Araneta's new holding company "as well as a five-year put option, which, when exercised, required Araneta to buy out ATR's interest at the higher of (i) the issue price of ATR's shares plus a premium of between 22% and 25% per year, or (ii) the adjusted book value of ATR's shares." Compl. at Ex. A, p. 4.

In accordance with his promise in the Undertaking Agreement, Araneta incorporated the Delaware Holding Company in January 2000. Compl. at Ex. A, p. 4. Thereafter, he "presented ATR with 3,000 of its shares (10%) while personally retaining control over the residual 27,000 shares (90%). Likewise, Araneta appointed and dominated the Delaware Holding Company's board of directors, which consisted of himself, defendants [Liza] Berenguer ..., and defendant Bonilla (the head of LBC's U.S. operations)." Compl. at Ex. A, p. 4. The court found that in late 2000 or early 2001, Araneta also fulfilled his promise in the Undertaking to contribute the LBC Operating Companies to the Delaware Holding Company. Compl. at Ex. A, p. 10-13.

///

B. Findings Regarding The Transfer Of Assets

Nearly three years after the Delaware Holding Company was incorporated, a rift developed between Araneta and ATR's chairman, Ramon Arnaiz. Compl. at Ex. A, p.5. Apparently in response, Araneta "transferred all of the LBC Operating Companies out of the Delaware Holding Company." Compl. at Ex. A, p. 5. As evidenced by documents showing the financial status of the Delaware Holding Company during the last nine months of 2003, Araneta responded with hostility by stripping the Delaware Holding Company of the LBC Operating Companies, resulting in a *de facto* liquidation of the business. Compl. at Ex. A, p.6. The financial statements show that in March 2003, the Delaware Holding Company "reflected approximately $36 million in 'investments' and approximately $39 million in 'liabilities.'" Compl. at Ex. A, p.6. "The 'investments' referred to the LBC Operating Companies and the Professional Holdings shares purchased for Araneta by ATR's Advances ... [and the] 'liabilities' represented the pro rata amounts due to Araneta and ATR as a result of the equity positions that each gained for their capital contributions." Compl. at Ex. A, p.6. The financial sheets for December 2003 show that the Delaware Holding Company retained $937,500 in 'investments' and $3.922 million in 'liabilities.'" Compl. at Ex. A, p.6.

C. Findings Regarding Failure To Provide Records To ATR

After the rift developed between Araneta and Arnaiz, Araneta rebuffed ATR's repeated requests for "information on the condition of the Delaware Holding Company in which it still had nearly $4 million invested." Compl. at Ex. A, p.6. In response, ATR's attorneys formally demanded ATR's right to review the Delaware Holding Company's books and records by letter dated July 18, 2003. Compl. at Ex. A, p.6. The letter asserts that ATR is exercising its right as a Delaware corporation stockholder to request the Delaware Holding Company's financial statements, documents showing that the Delaware Holding Company owns of the LBC Operating Companies, and documents evidencing Araneta's interest in the Pre-Need Company. Compl. at Ex. A, p.6. Araneta's son, his lawyer and Bonilla were sent copies of the demand letter. Compl. at Ex. A, p.6 n.22. ATR warned that if its demands were denied, it would sue to protect its interests. Compl. at Ex. A, p.6. "Araneta ... instructed Bonilla not to provide the requested information." Compl. at Ex. A, p.6.

D. Findings Regarding Resignation Of The Delaware Holding Company's Board Of Directors

A Delaware Holding Company board of directors resolution produced by Araneta and dated May 22, 2003 states that Araneta putatively resigned his directorship, along with the other directors, including Bonilla, effective that day. Compl. at Ex. A, p.7. Araneta's secretary, Marites Vicente, was appointed as the President and sole director of the Delaware Holding Company. Compl. at Ex. A, p.7. The following day, Araneta himself approved a board resolution to change the name of the Delaware Holding Company. Compl. at Ex. A, p.8.

However, the court found, based on the directors' actions and the testimony, that none of them left the Delaware Holding Company's board of directors. Compl. at Ex. A, p.7-9. Bonilla testified that he did not know that Vicente was appointed to the board. Compl. at Ex. A, p.8. Upon receipt of the resolution purporting to change the name of the Delaware Holding Company, Bonilla acted as a director by performing the tasks necessary to amend the Delaware Holding Company's charter. Compl. at Ex. A, p.8. "Moreover, in his mind, Bonilla continued to serve as a director of the Delaware Holding Company until December 2003." Compl. at Ex. A, p.8.

E. The Court's Rulings Pertaining To Bonilla's Liability

The Memorandum Opinion notes that the issue of Bonilla's liability to ATR is challenging in part because "ATR does not allege that ... Bonilla participated in, approved of, or directly profited from Araneta's removal of the LBC Operating Companies. Rather, ATR claims that Bonilla ... consciously breached the important duties articulated in this court's *Caremark* decision and recently reaffirmed by our Supreme Court in *Stone v. Ritter*." Compl. at Ex. A, p.19, citing *Caremark, Int'l, Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996) and *Stone v. Ritter*, 911 A.2d 362 (Del. 2006). The court cited the *Caremark* and *Stone* decisions to establish that corporate directors have duties to "monitor the potential that others within the organization will violate their duties," which, in turn, imposes upon directors a duty to try "'in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists.'" Compl. at Ex. A, p.19, citing *Caremark*, 698 A.2d 959, 970. In order to impose liability on corporate directors for failure to carry out such oversight duties, the court must find that the directors "utterly failed to implement any reporting or information system or controls" or, in the event that an information system or control

was in place, that the directors "consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." Compl. at Ex. A, p.19, citing *Caremark*, at 970. The court must show that "the directors knew that they were not discharging their fiduciary obligations." Compl. at Ex. A, p.19.

The court found that "no reporting system was in place and that no other information systems or controls were ever considered, let alone implemented, by the Delaware Holding Company board of directors. As a result, the directors were often unaware of corporate activities – despite how easy that would have been given the Delaware Holding Company's modest size." Compl. at Ex. A, p.20. Bonilla testified that there had been no board meetings since January 2001, and that "when the Delaware Holding Company's name was changed from LBC Global, Corp. to PHMI Holdings, Corp., he was never informed about the change, never voted to approve it, and did not even know what the initials PHMI in the new corporate name stood for at the time he signed the certificate of amendment as the corporation's authorized agent." Compl. at Ex. A, p.20. Bonilla deferred to Araneta in Delaware Holding Company matters, and testified that he would not "undertake an independent inquiry if told to act by Araneta" because "Araneta and the Delaware Holding Company were basically one and the same." Compl. at Ex. A, p.20.

Based on these findings, the court found that Bonilla failed to uphold his fiduciary duty of loyalty to the Delaware Holding Company. Compl. at Ex. A, p.20-21. Accordingly, the court ruled that "[a]lthough it is clearly the case that Araneta is the most culpable of the defendants, Bonilla ... [is] accountable for [his] complicity in [Araneta's] endeavors." Compl. at Ex. A, p.1.

F. Damages

The court found that it was impractical "to require Araneta to return control of the LBC Operating Companies to the Delaware Holding Company" because "it would likely take years and years to chase Araneta and his family across the nation ... and across the globe to get that type of order implemented." Compl. at Ex. A, p.21. Instead, because Araneta effectively liquidated the Delaware Holding Company, the court determined that ATR should be made "whole for the injury it suffered by entrusting its capital to the Delaware Holding Company, only to see that corporation impoverished by the defendants." Compl. at Ex. A, p.21. Thus, the court awarded ATR "the cost of

acquiring its equity in the Delaware Holding Company – $3.922 million – plus pre-judgment interest at a rate that fairly compensates ATR for its loss of the upside inherent in the LBC Operating Companies' profit and growth." Compl. at Ex. A, p.21. The court also stated that:

> All of the defendants will be jointly and severally liable for the amount of the judgment. Nonetheless, I find that in any action as between Araneta, on the one hand, and Bonilla and Berenguer, on the other, Araneta should be deemed responsible to pay the entire judgment. In other words, to the extent it is later important, if Bonilla and Berenguer pay any or all of the judgment, Araneta should be required to make them whole, to the extent that it is consistent with applicable law.
>
> Compl. at Ex. A, p.22.

In considering ATR's request for attorneys' fees, the court stated that fees are only awarded in exceptional circumstances, including "fraud, bad faith, or other outrageous conduct from which the claim arose and bad faith behavior in the course of subsequent litigation." Compl. at Ex. A, p.22. Finding that Araneta's bad faith was pervasive prior to and during the litigation, the court ruled that Araneta must pay ATR's attorneys' fees and expenses. Compl. at Ex. A, p.23. Further, the court entered an order required Araneta "to bear any additional attorneys' fees and expenses ATR is forced to bear in seeking to collect on this judgment." Compl. at Ex. A, p.23. But, finding that Bonilla did "not engage[] in conduct that satisfies the exacting bad faith standard required for fee shifting", the court ruled that Bonilla is not jointly and severally liable for the fee-shifting award. Compl. at Ex. A, p.23.

III. ATR'S FOURTH CAUSE OF ACTION FAILS TO STATE FACTS CONSTITUTING A CLAIM FOR RELIEF UNDER § 523(a)(4)

A. Rule 12(b)(6) Standards

A motion to dismiss a claim for relief pursuant to Federal Rule of Civil Procedure 12(b)(6) is applicable to adversary proceedings. Fed. R. Bankr. Proc. 7012(b). "In considering a motion to dismiss a complaint for failure to state a claim, FRCP 12(b)(6), the bankruptcy court must take as true all allegations of material fact and construe them in the light most favorable to the nonmoving party." *Busseto Foods v. Laisure (In re Laizure)*, 349 B.R. 604, 606 (B.A.P. 9th Cir. 2006). "In ruling on a 12(b)(6) motion, a court may generally consider only allegations contained in the pleadings, exhibits attached to the complaint, and matters properly subject to judicial notice." *Swartz v. KPMG LLP*, 476 F.3d 756, 763 (9th Cir. 2007); citing *Jacobson v. Schwarzenegger*, 357 F.

Supp. 2d 1198, 1204 (C. D. Cal. 2004). "Dismissal is proper under Rule 12(b)(6) if it appears beyond doubt that the non-movant can prove no set of facts to support its claims." *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1046 (9th Cir. 2006), citing *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001) citing *Adams v. Johnson*, 355 F.3d 1179, 1183 (9th Cir. 2004).

B. Under Delaware State Law, The Doctrine Of Collateral Estoppel Does Not Apply Unless The Issue Previously Decided Is Identical To The One Presented In The Current Action

"The Supreme Court has held that 'collateral estoppel principles do indeed apply in discharge proceedings pursuant to § 523(a).'" *In re Cantrell*, 329 F.3d 1119, 1123 (9th Cir. 2003), citing *Grogan v. Garner*, 498 U.S. 279, 284 n.11, 112 L. Ed. 2d 755, 111 S. Ct. 654 (1991). "In addition, 28 U.S.C. § 1738 requires us, as a matter of full faith and credit, to apply the pertinent state's collateral estoppel principles." *In re Cantrell*, 329 F.3d 1119, 1123, citing *Gayden v. Nourbakhsh (In re Nourbakhsh)*, 67 F.3d 798, 800 (9th Cir. 1995); *Newsom v. Moore (In re Moore)*, 186 B.R. 962, 968-70 (Bankr. N.D. Cal. 1995).

As explained in ATR's complaint, its underlying judgment against Bonilla was entered in the Delaware Court of Chancery (Compl. at ¶ 7), and thus, Delaware state law governs the application of collateral estoppel to the underlying judgment. Under Delaware law, the following four elements must be shown to support a claim of collateral estoppel:

> (1) The issue previously decided is identical with the one presented in the action in question,
> (2) the prior action has been finally adjudicated on the merits,
> (3) the party against whom the doctrine is invoked was a party or in privity with a party to the prior adjudication, and
> (4) the party against whom the doctrine is raised had a full and fair opportunity to litigate the issue in the prior action.

Norm Gershman's Things to Wear, Inc. v. Peterson (In re Peterson), 332 B.R. 678, 683 (Bankr. Del. 2005), citing *Betts v. Townsends, Inc.*, 765 A.2d 531, 535 (Del. 2000). The reason that ATR's underlying Delaware judgment does not support a collateral estoppel claim is that the first element is not met. The issues which were decided in the underlying judgment are not identical to and do not resolve the issues before this court on ATR's Section 523(a)(4) claim. Particularly, and as explained in the following, the Delaware judgment does not address, much less find that Bonilla had fiduciary duties to ATR which were imposed by an express or statutory trust.

C. Bankruptcy Code Section 523(a)(4)

Bankruptcy Code Section 523(a)(4) precludes a debtor's discharge on a debt only "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4). "A debt is nondischargeable under 11 U.S.C. § 523(a)(4) where '1) an express trust existed, 2) the debt was caused by fraud or defalcation, and 3) the debtor acted as a fiduciary to the creditor at the time the debt was created.'" *In re Niles*, 106 F.3d 1456, 1459 (9th Cir. 1997), citing *Klingman v. Levinson*, 831 F.2d 1292, 1295 (7th Cir. 1987). ATR does not and cannot set forth facts that an express trust or technical trust existed or that the underlying debt was caused by fraud, as explained in the following:

1. A Debt Is Non-Dischargeable Under Section 523(a)(4) Where The Debtor's Fiduciary Duties To The Creditor Were Imposed Pursuant To An Express Or Statutory Trust

"[I]t is well established in the Ninth Circuit that an express or statutory trust relationship must exist between the parties in order for a debt to be found nondischargeable under 11 U.S.C. § 523(a)(4)." *In re Moore*, 186 B.R. 962, 974. Federal law defines the term "fiduciary capacity" and limits the term to express or technical trust relationships Section 523(a)(4). *Id.*; *Blyler v. Hemmeter (In re Hemmeter)*, 242 F.3d 1186, 1189 (9th Cir. 2001), citing *Lewis v. Scott (In re Lewis)*, 97 F.3d 1182, 1185 (9th Cir. 1996). The term "fiduciary" excludes "trusts *ex maleficio, i.e.*, trusts that arose by operation of law upon a wrongful act." *In re Hemmeter*, 242 F.3d 1186, 1189, citing *Davis. v. Aetna Corp.*, 293 U.S. 328, 333, 79 L.Ed. 393, 55 S. Ct. 151 (1934); *Chapman v. Forsyth*, 43 U.S. 202, 2 HOW 202, 208, 11 L. Ed. 236 (1844). "We have adhered to this construction in interpreting the scope of 11 U.S.C. § 523(a)(4), refusing to deny discharge to those whose fiduciary duties were established by constructive, resulting and implied trusts." *In re Hemmeter*, 242 F.3d at 1189-90, citing *Runnion v. Pedrazzini (In re Padrazzini)*, 644 F.2d 756, 758 (9th Cir. 1981) and *Schlecht v. Thornton (In re Thornton)*, 544 F.2d 1005, 1007 (9th Cir. 1976). "The broad, general definition of fiduciary – a relationship involving confidence, trust and good faith – is inapplicable to the dischargeability context." *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986).

In the Ninth Circuit, "[a] debtor is only a 'fiduciary' for purposes of § 523(a)(4), where state law imposes an *express or statutory trust* on the funds at issue." *In re Niles*, 106 F.3d 1456, 1463

(9th Cir. 1997), italics added. For example, in the matter of *In re Niles*, 106 F.3d 1456, 1463, the court found that that debtor, a licensed real estate broker, acted as fiduciary with respect to a property management account because she was required either to collect rents for the plaintiffs as their broker, and then pay funds from the account directly to the plaintiffs or to hold them in a trust account. *In re Niles*, 106 F.3d 1456, 1459. Thus, the debtor was the trustee of an express trust, and her fiduciary relationship to the plaintiffs arose prior to her wrongdoings which caused her to become indebted to the plaintiffs. *Id.*

An example of a *statutory trust* which complies with Section 523(a)(4)'s requirements is set forth in the matter of *In re Hemmeter*, which held that Employee Retirement Income Security Act plan fiduciaries are also fiduciaries within the meaning of Section 523(a)(4). *In re Hemmeter* at 1189-90. The *Hemmeter* court stated that:

> A statutory fiduciary is considered a fiduciary for the purposes of § 523(a)(4) if the statute: (1) defines the trust res; (2) identifies the ficuciary's fund management duties; and (3) imposes obligations on the fiduciary prior to the wrongdoing.

Id. at 1190. The court reviewed ERISA and found that (1) it defines the trust res as the creation of the plan itself; (2) identifies the fiduciary's fund management duties; and (3) states that the ficuciary's duties arise upon creation of an ERISA plan. *In re Hemmeter* at 1190. Thus, "ERISA satisfies the traditional requirements for a statutory fiduciary to qualify as a fiduciary under § 523(a)(4)." *Id.*, citing *Morgan v. Musgrove (In re Musgrove)*, 187 B.R. 808, 814 (Bankr. N.D. Ga. 1995).

2. Delaware State Law Does Not Impose Express Or Statutory Trusts On Corporate Directors, But Imposes A Constructive Trust On Corporate Funds, Pursuant To The Delaware Trust Fund Doctrine, When Corporate Directors Profit From Their Wrongdoing

Because Delaware was the state of incorporation of the Delaware Holding Co. (Compl. at ¶ 12), Delaware state law determines whether there was an express or statutory trust which imposed trust duties on Bonilla, as meant by Section 523(a)(4). It is clear that Delaware law does not impose an express or statutory trust on corporate directors, as explained in *Miramar Resources, Inc. v. Arthur Shultz (In re Arthur Shultz)*, 208 B.R. 723 (Bankr. M.D. Fl. 1997). There, the court held that Delaware law does not impose express or statutory trust duties on corporate directors. But, when a

corporation becomes insolvent as a result of the director's wrongdoing, and where the defendant profits from his wrongdoing, the Delaware Trust Fund Doctrine is implicated and imposes trust duties on a corporate director sufficient to satisfy section 523(a)(4). In contrast, Judge Marilyn Morgan, who extensively analyzed the history and scope of the Delaware Trust Fund Doctrine in *Decker v. Mitchell (In re JTS Corp.)*, 305 B.R. 529, 535 (Bankr. N.D. Cal. 2003), found that the Delaware Trust Fund Doctrine imposes a *constructive trust*, rather than a true trust, as an equitable remedy where corporate directors profit from their wrongdoing. Thus, even if the Delaware Trust Fund Doctrine is implicated, it does not meet the Section 523(a)(4) strict requirement for an express or statutory trust. The only contrary authority is *Miramar Resources, Inc. v. Zachary L. Shultz (In re Zachary Shultz)*, 205 B.R. 952 (Bankr. NM 1997) which dispensed with the "express or statutory trust" element, but without offering a cogent explanation.

a. Miramar Resources, Inc. v. Arthur C. Shultz

In the matter of *Miramar Resources, Inc. v. Arthur C. Shultz (In re Arthur Shultz)*, 208 B.R. 723 (Bankr. M.D. Fl. 1997), Miramar Resources, Inc. filed a complaint against the debtor to determine the dischargeability under Section 523(a)(4) of Miramar's prior judgment against the debtor for breach of fiduciary duty. *Arthur Shultz*, at 725. Prior to the debtor's bankruptcy case, the debtor had been a member of Miramar's board of directors. *Id.* at 727. Most of the members were part of debtor's family ("Family Directors") and the minority of the members were "outsider" members. *Id.* at 727. Miramar's underlying judgment against the Family Directors, including the debtor, was the result of the actions of one of the Family Directors, who brokered various transactions with another company, whereby Miramar would sell most of its assets to the other company for no consideration to the company, and assign Miramar's oil and gas leases to one of the other Family Directors. *Id.* at 727. Soon after, the board passed resolutions authorizing the transactions over the objections of the "outsider" members, who requested that the board obtain a fairness opinion prior to approving the transaction. *Id.*

The court rejected Miramar's contention that the "express trust" element of Section 523(a)(4) was established "under Delaware law, [which holds that] directors of a corporation stand in the position of trustees with the shareholders" *Id*, citing *Petty v. Penntech Papers, Inc.*, 347 A.2d 140

(Del. Ch. 1975). The court stated that:

> although state law is relevant in the determination of fiduciary duties under § 523(a)(4), the bankruptcy courts must find 'an express or technical trust' giving rise to the fiduciary duty. [citation]. The express or technical trust aspect of Section 523(a)(4) requires that there be 'a segregated trust *res*, an identifiable beneficiary, and affirmative trust duties established by contract or by statute.

Id. at 729, citing *Davis v. Aetna Acceptance Corp.*, 293 U.S. 328, 79 L. Ed. 393, 55 S. Ct. 151 (1934) and *American Surety & Casualty Co. v. Hutchinson (In re Hutchinson)*, 193 B.R. 61, 65 (Bankr. M.D.Fla. 1996). Thus, although Delaware law imposes trust duties on corporate officers, "this fact alone does not establish an express or technical trust as required for an exception from discharge under Section 523(a)(4)." *Id.* at 728-29. Accordingly, "[t]he defendant's position as a director does not per se make him a trustee to the corporation. ... [A]dditional proof was needed to fulfill the 'express or technical trust' requirement." *Id.* at 729.

The court next considered Miramar's second argument, that a trust relationship existed pursuant to the Delaware Trust Fund Doctrine, which arises upon a corporation's insolvency or where the corporation is on the brink of insolvency, and which imposes on the board of directors a duty to the corporate enterprise and its creditors. *Id.*, citing *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications, Co.* 1991 Del. Ch. LEXIS 215, No. 12150, 1991 WL 277613 at *34 (Del Ch. Dec. 30, 1991) and *Arkansas v. Fatjo*, 1993 U.S. Dist. LEXIS 7911 at *14, 1993 WL 208440 at *5 (S.D.Tex.). The *Arthur Schultz* court found that the Delaware Trust Fund Doctrine was implicated because the defendant's wrongdoing resulted in Miramar's insolvency, and permitted him to profit from his wrongdoing. Specifically, the defendant knew that the proposed board resolutions would result in Miramar's insolvency, and despite the fact that the defendant knew that the outside directors objected to the transaction and had requested a fairness opinion, the defendant failed to act in the best interest of the other directors and shareholders. *Arthur Shultz*, at 729, italics added. Consequently, the court ruled that Miramar established the "express or statutory trust" element required under Section 523(a)(4).

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b. The Delaware Trust Fund Doctrine Imposes A Constructive Trust Rather Than An Express *Trust Where Inequity Results From Personal Profit By The Insiders, Which Have Engaged In Wrongdoing Resulting In The Corporation's Insolvency*

In contrast to the *Arthur Shultz* court, Judge Morgan extensively reviewed the history and scope of the Delaware Trust Fund Doctrine in the matter of *Decker v. Mitchell (In re JTS Corp.)*, 305 B.R. 529, 535 (Bankr. N.D. Cal. 2003)(finding that the Delaware Trust Fund Doctrine, which is not relied upon in the strict sense and which does not truly create a trust, is different from the insolvency exception, which imposes fiduciary duties on the corporate directors, but which does not impose a trust on the corporate assets) and concluded, based upon case law interpreting the Delaware Trust Fund Doctrine, including the seminal case, *Bovay v. H.M. Byllesby & Co.*, 27 Del. Ch. 381, 38 A.2d 808 (Del. 1944), that "directors are not trustees in a strict and technical sense but may be treated as such when they have 'unlawfully profited through breach of duty, and at the expense of the corporation.'" *In re JTS Corp.*, 305 B.R. at 538, citing *Bovay*, 38 A.2d at 813. The Delaware Trust Fund Doctrine applies where inequity results "from a combination of two factors []: personal profit by the insiders and harm to the corporation leading to its insolvency." *In re JTS Corp.*, 305 B.R. 529, 538, citing *Bovay*, 38 A.2d 808, 813. This court also noted that:

> In the years following *Bovay*, Delaware law has not followed an uncompromising trust fund doctrine. Although the supreme court has not had an opportunity to discuss the issue further, the lower courts, while still citing Bovay, have generally turned away from describing directors of an insolvent corporation as guardians of a trust fund for the benefit of creditors. ... [A] litany of cases demonstrates that Delaware law has never relied on the trust fund doctrine in the strict sense. ... Delaware's recognition that the trust fund doctrine is limited to the application of remedies designed to assure fairness is consistent with the construct trust concepts from which it arises. As one authority has noted, a constructive trust is a fiction of equity. It is 'a formula through which the conscience of equity finds expression.' Bogert, *The Law of Trust and Trustees*, § 471 at p. 8 (rev. 2d ed.). There is no true intent to create a trust, rather it is a devise used to work out an equitable result when a party has gained possession of property through unjust or unlawful means.
>
> *In re JTS Corp.* at 538, 540.

In contrast, the insolvency exception, which first appeared in *Harff v. Kerkorian*, 324 A.2d 215 (Del. Ch. 1974), imposes fiduciary duties on directors towards creditors when a corporation is insolvent. *In re JTS Corp.* at 539. "This new fiduciary relationship is certainly one of loyalty, trust and confidence, but it does not involve holding the insolvent corporation's assets in trust for

distribution to creditors or holding directors strictly liable for actions that deplete the corporate assets." *Id.*

c. Miramar Resources, Inc. v. Zachary L. Shultz

In the matter of *Miramar Resources, Inc. v. Zachary L. Shultz (In re Zachary Shultz)*, 205 B.R. 952 (Bankr. N.M. 1997), the court dispensed with Section 523(a)(4)'s "express or statutory trust" requirement. The *Zachary Shultz* debtor, like the debtor in the *Arthur Shultz* case, was one of the "Family Directors" of Miramar, and after filing a chapter 7 bankruptcy petition, was sued by Miramar pursuant to a Section 523(a)(4) adversary proceeding. *Zachary Shultz* at 954. But unlike the *Arthur Shultz* court, the *Zachary Shultz* court determined, based on the reasoning set forth in the decision of *In re Snyder*, 101 B.R. 822 (Bankr. Mass. 1989), that the "technical trust" requirement does not need to be applied in Section 523(a)(4) suits against corporate directors. *Zachary Shultz* at 958, citing *In re Snyder*, 101 B.R. 822, 835. Instead, 523(a)(4) denies discharge of a debt owed by a corporate director so long as the debt was "created by the person who was already a fiduciary at the time the debt was created.'" *Zachary Shultz* at 958, citing *In re Snyder*, 101 B.R. at 835. Following the rationale of *Snyder*, the *Zachary Shultz* court concluded that the elements of Section 523(a)(4) were met because Delaware state laws impose fiduciary and trust duties on corporate directors. *Zachary Shultz* at 958-59, citing Del. Code Ann. tit 8 §§ 102(b)(7), 141(a).

The *Zachary Shultz* decision does not comport with the Ninth Circuit's strict requirement that either an express or statutory trust exist in order to implicate non-dischargeability under Section 523(a)(4) and is thus not binding on this court. The *Zachary Shultz* decision fails to cite Delaware law stating that corporate directors and officers are trustees under an *express trust*, which identifies a segregated trust *res* and a beneficiary, as well as affirmative trust duties. And the *Zachary Shultz* decision does not cite a Delaware statute which imposes *statutory fiduciary* duties on corporate directors and officers whereby (1) the trust res is defined; (2) the fiduciary's funds management duties are identified; and (3) obligations are imposed on the fiduciary prior to the alleged wrongdoing.

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3. ATR Fails To State A Claim For Relief Under Section 523(a)(4) Because Neither ATR's Complaint Nor The Findings And Holding Set Forth In The Memorandum Opinion Establish That Bonilla's Duties To ATR Were Imposed Pursuant To An Express Or Statutory Trust

ATR fails to set forth facts satisfying the "express or statutory trust" element under Section 523(a)(4). In its complaint, ATR alleges that:

> as a director of a Delaware corporation, Bonilla stood in the position of a trustee for the shareholders of the Delaware Holding Company, including ATR. That trust relationship predated the debt owed by Bonilla to ATR and existed without reference to that debt.

Compl. at ¶ 74. Neither this allegation nor the Delaware Chancery Court's findings establish that an express or statutory trust existed which imposed trust duties on Bonilla, as follows:

a. ATR Fails To Allege That An Express Trust Imposed Trust Duties On Bonilla

ATR does not allege that an express trust existed under Delaware law which imposed fiduciary duties on Bonilla. Further, ATR does not allege that the express trust identified a segregated trust *res* and a beneficiary, or affirmative trust duties imposed on Bonilla.

ATR also cannot rely on the Memorandum Opinion to establish that an express trust existed which imposed fiduciary duties on Bonilla. The Delaware Chancery Court found that Delaware state law imposed upon Bonilla, as a director of the Delaware Holding Company, a duty of loyalty to ATR and to the Delaware Holding Company. Compl. at Ex. A, p.19. Bonilla breached this duty by failing "to monitor the potential that others within the organization will violate their duties." Compl. at Ex. A, p.19. But, as explained by the *Arthur Shultz* court, the fact that Bonilla had duties to the Delaware Holding Company as a director does not mean that Bonilla was a trustee to the Delaware Holding Company per se. Further, the Memorandum Opinion does not including findings that Bonilla's fiduciary duties were imposed pursuant to an express trust, much less identify a segregated trust *res* and a beneficiary, or Bonilla's affirmative trust duties imposed by the express trust.

b. ATR Fails To Allege That A Statutory Trust Imposed Trust Duties On Bonilla

Likewise, ATR does not allege that Delaware imposed trust duties on Bonilla pursuant to a Delaware statute. ATR does not allege that a Delaware statute exists which (1) defines a trust res; (2) identifies Bonilla's funds management duties as a director of the Delaware Holding Company, or

otherwise; or (3) imposed said duties on Bonilla prior to the time that Araneta transferred the LBC Operational Companies from the Delaware Holding Company. The Memorandum Opinion does not including findings that a Delaware statute imposed statutory fiduciary duties on Bonilla, or that the statute (1) defines the trust res; (2) identifies the fiduciary's funds management duties; and (3) imposes such duties on the fiduciary prior to the alleged wrongdoing.

c. ATR Does Not State Facts Sufficient To Establish That Trust Duties May Be Imposed On Bonilla Pursuant To The Delaware Trust Fund Doctrine

ATR does not allege that the "express or statutory trust" element is met by the Delaware Trust Fund Doctrine, much less facts sufficient to support such a finding. ATR does not allege, and there are no findings in the Memorandum Opinion to support an allegation that imposition of the Delaware Trust Fund Doctrine is appropriate on the grounds that Bonilla unlawfully profited from a breach of duty which harmed the Delaware Holding Company, leading to its insolvency. ATR does not allege, and the Delaware Chancery Court did not find Bonilla *knew* that Araneta transferred properties from the Delaware Holding Company, that Bonilla *knew* that the transfers would cause the Delaware Holding Company to become insolvent, or that Bonilla *profited* from the transactions. Compl. at Ex. A, at 19.

Other findings in the Memorandum Opinion establish that the Delaware Trust Fund Doctrine does not apply. While the Delaware Chancery Court's finding that Bonilla complied with Araneta's instruction to not respond to ATR's document may establish that Bonilla was aware of a dispute between ATR and Araneta, the finding certainly does not establish that Bonilla knew about the transfers. The Memorandum Opinion states that "ATR does not allege that ... Bonilla participated in, approved of, or directly profited from Araneta's removal of the LBC Operating Companies." Compl. at Ex. A, at 19. Finally, the Delaware Chancery Court's decision to exclude Bonilla from the fee shifting award, on the basis that Bonilla did not engage in conduct satisfying the bad faith standard, including engaging in "fraud, bad faith or other outrageous conduct from which the claim arose," further erodes support for an allegation that Bonilla was aware of Araneta's transfers.

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d. Pursuant To This Court's Decision In The Matter Of JTS Corp., The Delaware Trust Fund Doctrine Does Not Impose Trust Duties Sufficient To Meet The "Express Or Statutory Trust" Requirement Under Section 523(a)(4)

Lastly, it is clear from this court's interpretation of the Delaware Trust Fund Doctrine, in the matter of *Decker v. Mitchell (In re JTS Corp.)*, 305 B.R. 529, 535 (Bankr. N.D. Cal. 2003), that the Delaware Trust Fund Doctrine does not impose trust duties sufficient to meet the "express or statutory trust" requirement under Section 523(a)(4). This court specifically found that:

> Delaware's recognition that the trust fund doctrine is limited to the application of remedies designed to assure fairness is consistent with the construct trust concepts from which it arises. ... There is no true intent to create a trust, rather it is a device used to work out an equitable result when a party has gained possession of property through unjust or unlawful means.

In re JTS Corp., 305 B.R. 529, 540. Accordingly, even if the Delaware Trust Fund Doctrine imposed trust duties on Bonilla, such duties arose from a *constructive trust*, rather than from an "express or statutory trust." And the Ninth Circuit will not deny discharge to those whose fiduciary duties were established by constructive trusts. *In re Hemmeter*, 242 F.3d 1186, 1189-90 (9th Cir. 2001). Accordingly, imposing trust duties on Bonilla pursuant to the Delaware Trust Fund Doctrine does not result in a denial of Bonilla's right to discharge his debt to ATR under Section 523(a)(4).

In conclusion, ATRs fourth claim for relief fails to pass muster under the Rule 12(b)(6) analysis: taking as true all of ATR's material allegations and construing them in a light most favorable to ATR, ATR has not set forth facts establishing that the "express or statutory trust" element required before this court may determine that Bonilla's debt to ATR is nondischargeable under Section 523(a)(4). Further, the Delaware judgment does not apply to preclude Bonilla from moving to dismiss ATR's complaint because the Delaware Chancery Court did not address or resolve the issue of whether an express or statutory existed which imposed fiduciary duties on Bonilla.

D. ATR Fails To State Facts Sufficient To Support Its Claim That Bonilla Committed "Fraud While Acting In A Fiduciary Capacity" Because ATR Does Not Allege That Bonilla Intentionally Deceived ATR

"Establishing fraud [for the purposes of section 523(a)(4)] requires a showing of a positive intentional act involving moral turpitude." *G.W. White & Son v. Tripp (In re Tripp)*, 189 B.R. 29, 35

(Bankr. N.D.N.Y. 1995). "The fraud definition is the same as that stated for 523(a)(2)(A)." *In re McDaniel*, 181 B.R. 883, 887 (Bankr. .S.D. Tex. 1994). And under section 523(a)(2), "the debtor must have intended to deceive the creditor." *Harmon v. Kobrin (In re Harmon)*, 250 F.3d 1240, 1249 n.10 (9th Cir. 2001); 4 COLLIER ON BANKRUPTCY (15th ed. 2006) at ¶ 523.10[1][a]("'Fraud' for purposes of this exception has generally been interpreted as involving intentional deceit, rather than implied or constructive fraud").

ATR does not allege that Bonilla intentionally deceived ATR, and the Delaware judgment did not find that Bonilla intentionally deceived ATR. Rather, the Delaware Chancery Court specifically found that Bonilla did "not engage[] in conduct that satisfies the exacting bad faith standard required for fee shifting", namely, "fraud, bad faith, or other outrageous conduct from which the claim arose and bad faith behavior in the course of subsequent litigation" and thus ruled that Bonilla is not jointly and severally liable for the fee-shifting award. Compl. at Ex. A, p.23. Accordingly, ATR has failed to state a claim for relief on the basis that Bonilla's debt to ATR was due to fraud, pursuant Section 523(a)(4), and ATR cannot rely upon the Delaware judgment to satisfy this element under Section 523(a)(4).

IV. CONCLUSION

Based on the foregoing, the debtor prays that the fourth claim for relief set forth in ATR's complaint against Bonilla be dismissed. Because ATR cannot amend to cure the defects, the debtor also prays that ATR be denied leave to amend its complaint.

Dated: August 31, 2007

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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re HUGO N. BONILLA, Debtor.	Case No. 07-30309 Chapter 7 Case
ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, v. HUGO NERY BONILLA, Defendant.	Adv. Proc. No. 07-03079 Date: September 28, 2007 Time: 9:30 a.m. Place: 235 Pine Street Courtroom 23 San Francisco, California Judge: Hon. Thomas E. Carlson

MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO DEFENDANT'S MOTION TO DISMISS FOURTH CAUSE OF ACTION PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 12(b)(6)

EXHIBIT D

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INTRODUCTION

The Delaware Court of Chancery found Debtor Hugo N. Bonilla ("Defendant") liable to Plaintiffs ATR-Kim Financial Corporation and ATR-Kim Eng Capital Partners, Inc. (collectively, "Plaintiffs" or "ATR") for approximately $24.5 million as a result of his breach of fiduciary duties as a director of a Delaware corporation in which Plaintiffs were the minority shareholder. The Court found Defendant had "conscious[ly] disregard[ed]" his duties as a director by turning a blind eye while the controlling shareholder stripped the company of its most valuable assets. Defendant does not challenge the validity of the Delaware judgment or the findings of the Delaware Court. Nor can he; that judgment was affirmed *in total* by the Delaware Supreme Court.

Rather, Defendant contends that the Fourth Claim for Relief in Plaintiffs' Adversary Complaint—which alleges that Defendant's debt to ATR is non-dischargeable under Section 523(a)(4)[1]—should be dismissed because Plaintiffs cannot establish that Defendant was a "fiduciary" for purposes of that Code section. Defendant's argument fails as a matter of law.

First, the premise of this argument—namely, that Plaintiffs must satisfy the doctrine of collateral estoppel at this procedural juncture—is flawed. Although the question of collateral estoppel may come into play at a later stage (such as on Plaintiffs' motion for summary judgment or at trial), the question on a *motion to dismiss* is not the future applicability of collateral estoppel, but rather whether the Complaint, together with its attachments, states a claim for relief when viewed in the light most favorable to Plaintiffs. As discussed below, Defendant has failed to meet his burden under this standard.

Moreover, even if the doctrine of collateral estoppel were relevant at this procedural juncture, Defendant's argument is still misplaced. Defendant contends that collateral estoppel cannot apply here because the issues decided in Delaware are not "identical" to those relevant in a non-dischargeability action brought under Section 523(a)(4). However,

[1]Unless otherwise indicated, all statutory references are to the Bankruptcy Code (the "Code") (11 U.S.C. §101, *et seq.*).

the fact that the Delaware court (unsurprisingly) did not make findings specific to Section 523(a)(4) in no way prevents this Court from relying on the findings that the Delaware court *did* make in determining whether Defendant's debt is non-dischargeable. Indeed, it is exactly that approach that bankruptcy courts must take in assessing whether a prior judgment debt is non-dischargeable. *See, e.g., Miramar Resources, Inc. v. Shultz (In re Zachary Shultz)*, 205 B.R. 952, 955 (Bankr. D.N.M. 1997) (hereinafter "*Zachary Shultz*") ("so long as factual findings were made which permit that determination [under Section 523(a)(4)], this Court is bound by those findings and is barred from proceeding with relitigation of the same facts").

Second, the only substantive argument advanced in support of this motion—namely, that Defendant is not a "fiduciary" under Section 523(a)(4) because he was not the trustee of an "express" or "statutory" trust—is incorrect. The concept of a "trustee" for purposes of Section 523(a)(4) is not limited to cases in which there is an actual "trust agreement" or a statute that literally calls someone a "trustee." It also encompasses circumstances involving "trust-type" relationships. In ascertaining whether such trust-type relationship existed, bankruptcy courts must examine the common-law of the state in which debt arose.

Delaware law gives rise to the fiduciary duties at issue in this case, and an examination of Delaware case law reveals that Defendant's fiduciary obligations as a director of a corporation are exactly the kind of "trust-type" duties contemplated by Section 523(a)(4). Indeed, Delaware courts have held that "the fiduciary duty of corporate directors is a court created duty that historically springs from equity's experience with *trusts and trustees*." *Hynson v. Drummond Coal Co.*, 601 A.2d 570, 575 (Del. Ch. 1991) (emphasis added). Consistent with this approach, Delaware courts historically have compared a director's duties to those of a trustee and require directors to abide by exacting duties in their relationship with the corporation and its shareholders.

The correlation between the duties of a corporate director and those of a trustee also extends to the concepts of trust "res" and "beneficiary." Where, as here, the debtor is a corporate director, the trust "res" includes the assets of the corporation, and the beneficiaries

are the corporation and its shareholders. The Complaint and its attachments make plain that the trust "res" in this case was the assets that had been stripped from the Delaware corporation under Defendant's watch, and the "beneficiaries" were the corporation and ATR, who, as the minority shareholder, had an indirect ownership interests in the corporate assets.

Finally, Defendant's argument is inconsistent with *Zachary Shultz*, the only opinion to have comprehensively considered whether a Delaware director is a "fiduciary" within the meaning of Section 523(a)(4). After a careful review of Delaware law and controlling precedent, that court concluded that Delaware directors *are* fiduciaries for purposes of Section 523(a)(4) because, among other things, "[d]irectors of a [Delaware] corporation stand in the position of trustees with their stockholders." *Zachary Shultz*, 205 B.R. at 959. The only case that stands in contrast—*i.e.*, *Miramar Resources, Inc. v. Shultz (In re Arthur Shultz)*, 208 B.R. 723 (Bankr. M.D. Fla. 1997) (hereinafter "*Arthur Shultz*")—is a decision that even Defendant cannot completely endorse because it also concluded that a Delaware director was a "fiduciary" under Section 523(a)(4), albeit on different grounds. As a result, although Defendant purports to rely on *Arthur Schulz*, he is forced to spend a great deal of effort attempting to qualify and explain away the portions of that decision that contradict his position.

For all of these reasons, the Court should deny Defendant's motion in its entirety and permit the parties to litigate the merits of Plaintiffs' Fourth Claim for Relief.[2]

FACTUAL ALLEGATIONS IN COMPLAINT AND ITS ATTACHMENTS

Because Defendant has brought this motion under Federal Rule of Civil Procedure 12(b)(6), all statements of material fact in the Complaint and its attachment must be "taken

[2]If the Court disagrees and is inclined to grant this motion in any respect, Plaintiffs respectfully request an opportunity to file an amended Complaint to cure any deficiencies. *See In re Hammarstrom*, 95 B.R. 160, 161 n.1 (Bankr. N.D. Cal. 1989) ("It is well established that a court should not grant a Rule 12(b)(6) motion without leave to amend, if it appears that the Plaintiff can amend the complaint to allege facts sufficient to state a claim upon which relief can be granted").

as true and construed in the light most favorable to the plaintiff." *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 931 (9th Cir. 2003); *Durning v. First Boston Corp.*, 815 F.2d 1265, 1267 (9th Cir. 1987); *see also U.S. Express Lines Ltd. v. Higgins*, 281 F.3d 383, 388 (3rd Cir. 2002). The following facts are taken from both the Complaint in this action and the Memorandum Opinion issued by the Delaware Court of Chancery in *ATR-Kim Eng Financial Corporation, et al. v. Carlos R. Araneta, et al.*, (Delaware Court of Chancery No. CIV. A. 489-A), a copy of which is attached as Exhibit A to the Complaint and incorporated by reference therein.

I. THE INJURY TO ATR AND THE ENSUING DELAWARE LITIGATION.

Defendant's judgment debt to ATR arises out of his role as a director in a Delaware corporation (hereinafter the "Delaware Holding Company") in which ATR was a 10 percent minority shareholder. *See* Compl. ¶¶11-14 & Ex. A at *3-*5. The Delaware Holding Company was formed by Carlos Araneta ("Araneta"), a wealthy Philippine businessman who operates an international family of courier and remittance companies bearing the initials "LBC." *Id.* ¶¶10-11. Defendant is and, at all time relevant to this case, was president of LBC Holdings USA Corporation and head of Araneta's operations in the United States. *Id.* ¶10 & Ex. A at *20.

Beginning in 1999, Araneta entered into a series of business arrangements with ATR, which culminated in ATR advancing him $3.922 million to participate in a Philippine insurance venture. *See id.* ¶12 & Ex. A at *3. As a condition of this advancement, Araneta formed the Delaware Holding Company, making Plaintiffs 10 percent shareholders and retaining personal control over the remaining 90 percent. *Id.* ¶12 & Ex. A at *4. Araneta then transferred into the Delaware Holding Company both his portion of the insurance venture and also a group of LBC companies known as the "LBC Operating Companies." *Id.* ¶12 & Ex. A at *10-*13. The LBC Operating Companies were the "primary" asset of the Delaware Holding Company and had a book value of over $35 million. *Id.* ¶13 & Ex. A at *13, *15. Upon formation of the Delaware Holding Company, "Araneta appointed and dominated [its] board of directors, which consisted of himself, defendant Berenguer

(Araneta's niece and the CFO of the LBC group of companies), and defendant Bonilla . . . ." *Id.* Ex. A at *4; *see also* Compl. ¶14.

In November 2002, ATR decided to withdraw from the insurance venture with Araneta. *Id.* ¶16 & Ex. A at *5. Although this decision was permissible under the terms of the parties' agreements, Araneta felt aggrieved by it. *Id.* He reacted by stripping the Delaware Holding Company of its only "valuable assets" (*id.* ¶17 & Ex. A at *4)—the LBC Operating Companies—and by transferring them to members of his family without informing ATR or permitting them to share *pro rata* in the proceeds. *Id.* ¶17 & Ex. A at *13. As a result, ATR was left with a 10 percent interest in a company that was effectively a shell corporation. *Id.*

After its falling out with Araneta, ATR went to great lengths to obtain information about the financial state of the Delaware Holding Company. Among other things, it sent demand letters to Araneta and his agents, seeking an opportunity to review the books and records of the Company. *Id.* ¶19 & Ex. A at *6. Certain of these letters were copied to Bonilla, who, on the instructions of Araneta, refused to respond to them. *Id.* Starved for information (*id.* Ex. A at *6), ATR filed a compliance action in Delaware under Section 220 of the Delaware Corporations Code, seeking to obtain the requested records. *Id.* ¶20 & Ex. A at *6. It was only after being ordered to do so by the Delaware courts that Araneta turned over financial records to ATR. *Id.* Ex. A at *6. These records showed that, sometime during the last nine months of 2003, Araneta had stripped the Delaware Holding Company of its chief assets. *Id.* ¶20 & Ex. A at *6.

ATR filed suit against Araneta, Bonilla, and Berenguer in June 2004, alleging fraud and breach of fiduciary duty. *Id.* ¶21 & Ex. A at *7. The case went to trial in the Delaware Court of Chancery in August 2006 (*id.* ¶22) and on December 21, 2006, the Court issued a 54-page Memorandum Opinion, finding all three defendants liable for the injury to ATR. *Id.* ¶23 & Ex. A at *21. The Court entered its Final Order of Judgment (the "Delaware Judgment") on January 10, 2007, holding the defendants jointly and severally liable "in the amount of **$24,490,422.50**," plus post-judgment interest accruing at a rate of 11.25 percent

per year. *Id.* ¶24 & Ex. B at 1 (emphasis in original).[3]

II. THE FINDINGS AGAINST BONILLA.

Although Araneta was chiefly responsible for the harm to ATR, the Delaware Court devoted a substantial discussion to the role played by the Defendant (and his co-director, Berenguer) in the underlying action. The Court began by noting that, as a director of a Delaware corporation, Bonilla owed fiduciary duties to ATR, including the duty:

- "to monitor the potential that others within the organization will violate their [own] duties" (Compl. Ex. A at *19);
- "'to attempt in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists'" (*id.* (quoting *In re Caremark Int'l, Inc. Deriv. Litig.*, 698 A.2d 959, 970 (Del.Ch. 1996) ("*Caremark*")); and
- to "'exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary questions, so that it may satisfy its responsibility'" (*id.* (quoting *Caremark*, 698 A.2d at 970)).

The Court then found that Defendant (and his co-director Berenguer) had breached those duties by failing to monitor Araneta's actions and by choosing "total fealty to Araneta's conflicting interests instead" of their duty to the corporation and its shareholders. Compl. Ex. A at *21. Specifically, the Court found that Bonilla was responsible for:

- "allow[ing] Araneta to do whatever he wanted, without any examination of whether his conduct benefited the Delaware Holding Company and all of its stockholders, rather than simply Araneta personally" (*id.* Ex. A at *1);
- treating "Araneta and the Delaware Holding Company [as] basically one and the

[3]The Court also awarded an additional $863,059.89 in attorney's fees and costs against Araneta, "in light of his egregious misconduct both before and during litigation of this matter." Compl. Ex. B at 2.

same and [taking] the word of Araneta as being the word of the company" (*id.* Ex. A at *20);

- never "question[ing] the wisdom of Araneta's actions nor insist[ing] that corporate procedures be followed" (*id.*);
- "**consciously** abandon[ing] any attempt to perform [his] duties independently and impartially, as [he was] required to do by law" (*id.* Ex. A at *21 (emphasis added));
- evincing a "**willingness** to serve the needs of [his] employer, Araneta, even when that meant intentionally abandoning the important obligations they had taken on to the Delaware Holding Company and its minority stockholder, ATR" (*id.* (emphasis added));
- "never [taking] any steps to recover the LBC Operating Companies once [he] realized that those assets were gone" (*id.*); and
- "act[ing] as—no other word captures it so accurately—[a] stooge[] for Araneta, seeking to please him and only him, and having no regard for [his] obligations to act loyally towards the corporation and all of its stockholders" (*id.* Ex. A at *1).

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III. ALLEGATIONS OF THE PRESENT COMPLAINT.

Defendant filed a voluntary petition for Chapter 7 bankruptcy on March 16, 2007. *See In re Hugo Bonilla*, United States Bankruptcy Court, Northern District of California, Docket #07-30309 (docket entry #1). On July 23, 2007, ATR filed the instant adversary Complaint, seeking a declaration that Defendant was not entitled to a discharge because he had: (1) engaged in fraudulent transfers of real property within one year of the filing of the bankruptcy petition pursuant to Section 727(a)(2)(A) (*see* Compl. ¶¶63-65 (First Claim for Relief)); (2) failed to maintain books, documents, records and papers from which his financial condition or business transactions might be ascertained pursuant to Section 727(a)(3) (Second Claim for Relief); and (3) failure to explain satisfactorily the loss or deficiency of assets pursuant to Section 727(a)(5) (*see* Compl. ¶¶69-71 (Third Claim for Relief)).

In addition, in the Fourth Claim for Relief, Plaintiffs seek a determination that

Defendant's debt to ATR is non-dischargeable because it arises from "fraud or defalcation while acting in a fiduciary capacity," under Section 523(a)(4). Compl. ¶76. With respect to this claim for relief, Plaintiffs have alleged that

> 72. ATR incorporates by reference paragraphs 1-62 inclusive, as though fully set forth herein.
>
> 73. In his capacity as Director of a Delaware corporation, Bonilla owed fiduciary duties to ATR, the Delaware Holding Company's minority shareholder, that predated the debt in this case. Those pre-existing fiduciary duties imposed upon Bonilla the responsibility for safeguarding the value of the assets of the Delaware Holding Company and, thereby, preserving the value of ATR's interest as a minority shareholder in the Delaware Holding Company.
>
> 74. Further, as a director of a Delaware corporation, Bonilla stood in the position of a trustee for the shareholders of the Delaware Holding Company, including ATR. That trust relationship predated the debt owed by Bonilla to ATR and existed without reference to that debt.
>
> 75. Bonilla's failure—as found by the Delaware Chancery Court—to monitor Araneta's actions, to prevent him from removing assets from the Delaware Holding Company to his family members without consideration, or to take any steps to protect ATR's interest as a minority shareholder, facilitated and enabled Araneta's wrongful transfer of assets from the Delaware Holding Company, resulting in the misappropriation of funds held in a fiduciary capacity. Further, by failing to respond to ATR's discovery requests in the Delaware action, Bonilla failed properly to account for the investment ATR made in the Delaware Holding Company.
>
> 76. As a result of these actions, Bonilla's Judgment Debt to ATR arises from "fraud or defalcation while acting in a fiduciary capacity," within the meaning of 11 U.S.C. Section 523(a)(4) and therefore should be excepted from discharge. (Compl. ¶¶72-76)

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ARGUMENT

I. DEFENDANT'S MOTION SHOULD BE DENIED BECAUSE THE ALLEGATIONS IN THE COMPLAINT, IN CONJUNCTION WITH THE FINDINGS OF THE DELAWARE COURT, ESTABLISH THAT BONILLA IS A "FIDUCIARY" WITHIN THE MEANING OF SECTION 523(a)(4).

A. The Standard Of Review And Irrelevance Of Collateral Estoppel To This Motion.

A complaint or cause of action should not be dismissed under Rule 12(b)(6) "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957); *see also Amfac Mortgage Corp. v. Ariz. Mall of Tempe, Inc.*, 583 F.2d 426, 429-30 (9th Cir. 1978). "All allegations of material fact are taken as true and construed in the light most favorable to

the non-moving party." *Durning*, 815 F.2d at 1267.

Defendant begins by couching his argument by reference to collateral estoppel. According to Defendant, because Plaintiffs cannot meet one of the elements of that doctrine—identicality of issues between the Delaware case and this case (*see* Defendant's Memorandum of Points and Authorities Supporting Motion to Dismiss Complaint ("Def. Br.") at 7:7-28)—they cannot state a cause of action under Section 523(a)(4). There are two fundamental flaws with Defendant's approach.

First, Defendant's reliance on the doctrine of collateral estoppel is misplaced. It would be one thing if Defendant were attempting to use the doctrine as a defense to the Complaint, by showing that some issue central to this case already has been litigated and decided *against* Plaintiffs in another proceeding. *See, e.g., Idaho Potato Comm'n v. G & T Terminal Packaging, Inc.*, 425 F.3d 708, 713 n.3 (9th Cir. 2005) (noting that defensive collateral estoppel operates "to preclude a plaintiff from relitigating an issue that the plaintiff previously litigated unsuccessfully against a different party"). In this instance, by contrast, Defendant's argument is that one of the central issues in this action—the existence of an "express" or "technical" trust under Section 523(a)(4)—has *not been litigated or decided* in a prior proceeding. Although collateral estoppel eventually may be grounds for granting judgment to *Plaintiffs*, either on summary judgment or after trial (*see, e.g., Grogan v. Garner*, 498 U.S. 279, 284 (1991) (noting that it is the *creditor* who would seek "to minimize additional litigation by invoking collateral estoppel" in a non-dischargeability suit)) and therefore Defendant's arguments may be relevant then, the alleged absence of collateral estoppel does not entitle Defendant to a dismissal on the pleadings now. Put another way, for purposes of the present motion, it is not the applicability of collateral estoppel that matters, but rather whether the Fourth Claim for Relief, taken together with the attachments to the Complaint, and viewed in the light most favorable to Plaintiffs, fails to state a cause of action. *See* Fed. R. Civ. P. 12(b)(6).

Second, even if this were not the case and collateral estoppel *was* relevant to a resolution of this motion, that doctrine is of no assistance to Defendant. Defendant's only

objection to application of the doctrine is that one of the issues in this case—the "trust" issue under Section 523(a)(4)—is allegedly not "identical" to any of the issues decided in Delaware. *See* Def. Br. at 7:23-28. But this can hardly come as a surprise. The question before the Chancery Court in Delaware was whether the Defendant had breached his fiduciary duties to Plaintiffs as a matter of state corporate law, not whether he was entitled to a discharge under federal bankruptcy law. However, in answering the questions that were properly before it, the Delaware court made a host of *factual* findings, none of which were disturbed by the Delaware Supreme Court in its affirmance. It is those *factual findings*, in conjunction with the bankruptcy and applicable non-bankruptcy law, that support the determination that the Defendants' debt to Plaintiffs is non-dischargeable. As one bankruptcy court observed when confronted with virtually an identical situation,

> [r]egardless of whether Judge Brooks [who had decided the case giving rise to the underlying debt] specifically concluded that Shultz [a corporate director] owed Miramar [a Delaware corporation] a fiduciary duty which satisfies §523(a)(4), so long as factual findings were made which permit that determination, this Court is bound by those findings and is barred from proceeding with relitigation of the same facts. (*Zachary Shultz*, 205 B.R. at 955)

See also In re Dawley, 312 B.R. 765, 776 (Bankr. E.D. Pa. 2004) ("I . . . reject the Defendant's position that the failure of Judge McInerney to find Plaintiff liable for fraud or embezzlement forecloses my doing so if her findings support the elements of fraud while acting in a fiduciary capacity or embezzlement as construed under §523(a)(4)").

B. Defendant Was A "Fiduciary" For Purposes Of Section 523(a)(4).

Section 523(a)(4) provides in relevant part that "[a] discharge under Section 727 . . . does not discharge an individual debtor from any debt . . . for fraud or defalcation while acting in a fiduciary capacity." 11 U.S.C. §523(a)(4). Defendant does not dispute that he owes a debt to Plaintiffs or that the debt resulted from "defalcation"[4] while acting as a co-director of the Delaware Holding Company. Instead, he contends that he was not a

[4]"Defalcation is broadly defined to include any behavior by a fiduciary, including innocent, negligent, and intentional defaults of fiduciary duty resulting in failure to provide a complete accounting." *In re Briles*, 228 B.R. 462, 467 (Bankr. S.D. Cal. 1998).

"fiduciary" within the meaning of Section 523(a)(4) because his duties as a co-director were not imposed "pursuant to an express or statutory trust." Def. Br. at 8:10-11. Defendant then proceeds to give examples of "express" and "statutory" trusts (*see id.* at 8:1-19), which he asserts are inapposite to this case. Defendant's argument is flawed in several important respects.

1. Section 523(a)(4) Encompasses Circumstances In Which A Debtor Owes Trust-Like Obligations Pursuant To State Common-Law.

Contrary to the premise of Defendant's argument, the term "fiduciary" is not limited to cases in which there is a written trust agreement or a statute that specifically uses the term "trust" or "trustee." Rather, courts both in the Ninth Circuit and throughout the country have endorsed a more practical approach to Section 523(a)(4), recognizing that the terms "express" or "technical" trust encompass those circumstances in which "trust-type" obligations are imposed on a debtor pursuant to state common-law. *See, e.g., In re Teichman*, 774 F.2d 1395, 1399 (9th Cir. 1985) ("state law takes on importance in determining when a trust exists. The state may impose trust-like obligations on those entering into certain kinds of contracts, and these obligations may make a contracting party a trustee") (internal quotation marks omitted); *In re Stanifer*, 236 B.R. 709, 714 (9th Cir. BAP 1999) ("The 'technical' or 'express' trust requirement includes relationships in which trust-type obligations are imposed pursuant to statute or common law"); *In re Colton*, No. 05-56430-MM, 2007 WL 1615069, at *3 (Bankr. N.D. Cal. June 4, 2007) ("in some instances, a state statute or common law doctrine may impose trust-like obligations that are sufficient to satisfy the requirements of an express trust"); *cf. Lewis v. Short (In re Short)*, 818 F.2d 693, 695-96 (9th Cir. 1987) (holding that Washington common law imposed trustee-like duties on partners of partnership); *see also In re Bennett*, 989 F.2d 779, 784-85 (5th Cir. 1993) ("most courts today . . . recognize that the 'technical' or 'express' trust requirement is not limited to trusts that arise by virtue of a formal trust agreement, but includes relationships in which trust-type obligations are imposed pursuant to statute or common law"); *In re Moskowitz*, 310 B.R. 21, 30 (Bankr. E.D.N.Y. 2004) ("Technical or

express trusts include relationships where trust-type obligations are imposed pursuant to statute or common law"); *In re Cook*, 263 B.R. 249, 255 (Bankr. N.D. Iowa 2001) ("[t]he 'technical' or 'express' trust requirement is not limited to trusts that arise by virtue of a formal trust agreement, but includes relationships in which trust-type obligations are imposed pursuant to statute or common law"); *In re Sullivan*, 217 B.R. 670, 675 (Bankr. D. Mass. 1998) ("A technical trust is a trust that is imposed by law and may arise either by statute or common law").

In re Lewis, 97 F.3d 1182 (9th Cir. 1996) is illustrative. The issue there was whether the bankrupt, a business partner of one of the creditors, was a "fiduciary" under Arizona law for purposes of Section 523(a)(4) as a result of the business partnership. The Court examined the relevant Arizona statutes and concluded they were of no benefit to the plaintiffs because the fiduciary duties mentioned therein arise "only when the partner derives profits without consent of the partnership" and therefore were "the sort of trust *ex maleficio* not included within the purview of §523(a)(4)." *In re Lewis*, 97 F.3d at 1185 (internal quotations and citation omitted). The Court then considered language from Arizona case law, which it found more closely approached the description of a "trustee" required by Section 523(a)(4), in particular:

> The relation of partnership is fiduciary in character, and imposes upon the members of the firm the obligation of the utmost good faith in their dealings with one another with respect to partnership affairs, of acting for the common benefit of all the partners in all transactions relating to the firm business, and of refraining from taking any advantage of one another by the slightest misrepresentation, concealment, threat or adverse pressure of any kind. (*Id.* at 1186 (quoting *DeSantis v. Dixon*, 72 Ariz. 345, 236 P.2d 38, 41 (1951)).

Given this case and other similar cases, the Court held, "Arizona law imposes upon partners a fiduciary duty within the meaning of section 523(a)(4)." *In re Lewis*, 97 F.3d at 1186; *see also Ragsdale v. Haller*, 780 F.2d 794, 795-96 (9th Cir. 1986) (reaching same result under California law).

2. As A Delaware Director, Defendant Owed Similar Trust-Type Obligations To The Shareholders Of The Delaware Holding Company.

Delaware law has historically imposed "trust-type" duties on its directors that are at

least as demanding as those recognized in *In re Lewis*.[5] The starting point for this analysis is the fundamental principle of Delaware law "that directors are responsible for managing the business and affairs of a Delaware corporation and, in exercising that responsibility, they are charged with an unyielding fiduciary duty to the corporation and its shareholders." *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 269 (Del. Ch. 1989) (internal quotations omitted); *accord Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985); *see also Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003) ("The fiduciary duties of a director are unremitting and must be effectively discharged in the specific context of the actions that are required with regard to the corporation or its stockholders as circumstances change"); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del.Ch. 1939) ("A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate . . . director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers").[6] Those "unyielding fiduciary duties" include the duty of care and loyalty, and the subsidiary duty of good faith. *See Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006); *see also Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001) (noting that the "fiduciary responsibilities do not operate intermittently"); *In re Digex, Inc. S'holders Litig.*, 789 A.2d 1176, 1206 (Del. Ch. 2000) ("directors must at all

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[5]Although the question of whether a relationship is a fiduciary one within the meaning of Section 523(a)(4) is an issue of federal law, "[t]he determination relies . . . upon whether the requisite trust relationship exists under state law." *In re Stanifer*, 236 B.R. at 714. As Defendant himself recognizes (Def. Br. at 9:23-25), Delaware supplies the relevant law in this case.

[6]The fiduciary duties of a Delaware director are also recognized by the statutes of that state. *See, e.g.*, 8 Del. Code §102(b)(7) (a certificate of incorporation may contain "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of *fiduciary duty* as a director . . .") (emphasis added).

times abide by their fiduciary duties owed to the shareholders of the corporation").

These demanding fiduciary duties grow from the experience of Delaware courts interpreting the law of trusts. "[T]he fiduciary duty of corporate directors is a court created duty that historically springs from equity's experience with trusts and trustees."[7] *Hynson*, 601 A.2d at 575; *see also Zachary Shultz*, 205 B.R. at 958 ("[h]istorically, Delaware courts have held corporate directors to high fiduciary standards and have even described the fiduciary obligation in terms of a trust"). Although corporate directors in Delaware are not trustees in a technical sense,[8] the courts of that state have long analogized their obligations to those of trustees. As the Court of Chancery stated:

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[7]That the fiduciary obligations of a Delaware director spring from the law of trusts distinguishes this case from *In re Cantrell*, 329 F.3d 1119 (9th Cir. 2003), in which the Court held that California directors were not fiduciaries under Section 523(a)(4) because their obligations arose out of the law of *agency*. *See id.* at 1126 (citing California cases). Delaware courts, by contrast, have rejected the notion that corporate directors are agents of the corporation. *See Arnold v. Soc'y for Sav. Bancorp, Inc.*, 678 A.2d 533, 539-40 (Del. 1996) ("Directors, in the ordinary course of their service as directors, do not act as agents of the corporation . . . . An agent acts under the control of the principal. The board of directors of a corporation is charged with the ultimate responsibility to manage or direct the management of the business and affairs of the corporation. . . . A board of directors, in fulfilling its fiduciary duty, controls the corporation, not *vice versa*) (citations and footnote omitted); *accord Zachary Shultz*, 205 B.R. at 959 (holding that "it would be an analytical anomaly to treat corporate directors as agents of the corporation [under Delaware law] when they are acting as fiduciaries of the stockholders in managing the business and affairs of the corporation"). This facet of Delaware law also has been recognized by the Ninth Circuit. *See Vizcaino v. Microsoft Corp.*, 120 F.3d 1006, 1021 (9th Cir. 1997) ("Under Delaware's corporations law, however, the board of directors directs the affairs of the business but is *not* an agent of the corporation").

Further, although the Court in *In re Cantrell* relied on language from California cases to the effect that directors are "technically not trustees" (*see In re Cantrell*, 329 F.3d at 1126 (internal quotations omitted)), that language came from Delaware common law, and thus justifies a thorough analysis of Delaware law on this point.

[8]For example, for purposes of self-dealing (which is not an issue as to the Defendant in this case), Delaware law has different standards for corporate directors and trustees. *See Stegemeier v. Magness*, 728 A.2d 557, 562 (Del. 1999) (noting that directors are not "equated" with trustees for purposes of self-dealing and can engage in self-dealing if their actions are approved by the board or by the shareholders). Along those same lines, courts have held that the relationship between a corporate director and a shareholder is not as "thoroughly rooted" in the concepts of reliance and trust as a pure trustor-trustee relationship might be. *Price v. Wilmington Trust Co.*, No. Civ. A. No. 12476, 1996 WL 451318, at *4 (Del. Ch. Aug. 6, 1996); *see also Price v. Wilmington Trust Co.*, No. Civ. A. No. 12476, 1996 WL 560177, at *2 (Del.Ch.,1996) (noting that directors and trustees are different in the *degree* of trust that the law requires).

> Clearly directors of a corporation *stand in a position of trustees* with the stockholders, *Lofland v. Cahall*, 13 Del.Ch. 384, 118 A. 1 (1922); *Bowen v. Imperial Theaters, Inc.*, [] 13 Del.Ch. 120, 115 A. 918 (1922), and the utmost good faith and fair dealing are required of them, especially where their individual interests are concerned. (*Petty v. Penntech Papers, Inc.*, 347 A.2d 140, 143 (Del. Ch. 1975) (emphasis added))

See also Beneficial Indus. Loan Corp. v. Smith, 170 F.2d 44, 57 (3rd Cir. 1948) ("The right of a stockholder of a Delaware corporation to maintain a derivative suit on behalf of the corporation is based upon a breach of fiduciary duty by the directors or officers of the corporation. *The officers and directors of a Delaware corporation are trustees for its stockholders under Delaware law*") (emphasis added);[9] *see also In re Shoe-Town, Inc. Stockholders Litig.*, No. C.A. No. 9483, 1990 WL 13475, at *7 (Del. Ch. Feb. 12, 1990) (characterizing directors as "quasi trustees. . . . a director will be held as a trustee for the corporation he has undertaken to represent") (citations omitted). Thus, Delaware courts have held that "efforts by a fiduciary to escape a fiduciary duty, whether by a corporate director or officer *or other type of trustee*, should be scrutinized searchingly." *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 168 (Del. 2002) (emphasis added); *see also Prestancia Mgmt. Group, Inc. v. Virginia Heritage Found., II LLC*, No. Civ. A. 1032-S, 2005 WL 1364616, at *6 (Del. Ch. May 27, 2005) ("[a] fiduciary relationship is a situation where one person reposes special trust in and reliance on the judgment of another or where a special duty exists on the part of one person to protect the interests of another. The relationship connotes a dependence. The traditional relationships recognized by equity as 'special' are express trustees and corporate officers and directors"); *Grace v. Morgan*, No. Civ. A 03C05260JEB, 2004 WL 26858, at *2 (Del. Super. Jan. 6, 2004) (holding that the "classic examples" of "a special relationship of trust [that] exist[s] between the parties sufficient to establish the fiduciary duty" include "the trustee responsible for the trust *res* for the beneficiary and the corporate officer or director responsible to

[9] *But see Bovay v. H.M. Byllesby & Co.*, 29 A. 2d 801, 804 (Del. Ch. 1943) (holding that directors are not trustees of an express trust "in the true sense of that term" and therefore can benefit from the statutes of limitations applicable to claims in a court of law, rather than equity).

shareholders").

Viewed in this light, the "unyielding" fiduciary duties that a director of a Delaware corporation owes to the corporation and its shareholders are exactly the kind of "trust-type" obligations that Courts rely upon in applying Section 523(a)(4). *See In re Sullivan*, 217 B.R. at 676 (holding that debtor-director was a fiduciary for purposes of Section 523(a)(4) where relevant state law provided that the director's "duty is *in the nature* of a trust relationship") (quotations omitted; emphasis added). Indeed, it is hard to imagine a meaningful difference between the obligations imposed on the business partner in *In re Lewis*—*e.g.*, acting in the "the utmost good faith" toward each other (*In re Lewis*, 97 F.3d at 1186)—and those that are imposed on corporate directors under Delaware case law. *See Guth*, 5 A.2d at 510 (requiring "the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation"). In both cases, the applicable case law recognized a heightened responsibility, analogous to the law of trusts, that governs the actor's conduct.

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It was exactly these "trust-type" obligations which gave rise to Defendant's judgment debt in this case. The Delaware Court found that Defendant had breached his fiduciary obligations to the corporation and to its minority shareholder—ATR—by failing to monitor or question Araneta's conduct as required under Delaware corporate law. *See* Compl. Ex. A at *19-*21 (citing the decisions in *Caremark*, 698 A.2d 959, and *Stone*, 911 A.2d at 370). To put this finding in perspective, as the Delaware Court recognized, a violation of a director's oversight liability can only arise if:

> (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors *knew that they were not discharging their fiduciary obligations*. Where directors fail to act in the face of a known duty to act, *thereby demonstrating a conscious disregard for their responsibilities*, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith. (Compl. Ex. A at *19 (citing *Stone*, 911 A.2d at 370 (emphases added; footnotes omitted))

In concluding that Defendant had breached these duty, the Delaware Court by necessity

made some specific and stark findings against the Defendant, including finding that he had:

- "**consciously** abandoned any attempt to perform [his] duties independently and impartially, as [he was] required to do by law" (*Id.* at *21 (emphasis added));
- evidenced a "**willingness** to serve the needs of [his] employer, Araneta, even when that meant **intentionally** abandoning the important obligations they had taken on to the Delaware Holding Company and its minority stockholder, ATR" (*id.* (emphasis added)); and
- "chos[en] **total fealty** to Araneta's conflicting interests instead" of his duty "to be loyal to the Delaware Holding Company" (*id.* (emphasis added)).

It was these serious and deliberate breaches of fiduciary duty that prompted the Delaware court to conclude that Defendant was "jointly liable for Araneta's fiduciary violations." *Id.* Under these circumstances, it can fairly be said—as Plaintiffs have alleged in the Complaint—that Defendant "stood in the position of a trustee for the shareholders of the Delaware Holding Company" (Compl. ¶74) and that the debt to Plaintiff arose out of the breach of his trust-type obligations. *See In re Lewis*, 97 F.3d at 1186. Defendant's debt, accordingly, is non-dischargeable under Section 523(a)(4).[10]

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[10]Although courts are not unanimous on this issue, numerous cases hold that corporate directors are fiduciaries for purposes of Section 523(a)(4). *See, e.g., Meyer v. Rigdon*, 36 F.3d 1375, 1382 (7th Cir. 1994) ("In Indiana, a director owes a fiduciary duty to the corporation and its shareholders. . . . Therefore, Rigdon was acting in a fiduciary capacity with respect to the Bank and its shareholders"); *In re Hammond*, 98 F.2d 703, 705 (2nd Cir. 1938) ("The president of a private corporation has been held to be an 'officer' or a fiduciary within the meaning of the clause under discussion . . . . It can scarcely be doubted, and is not, we understand, disputed, that a director falls within the same category") (citation omitted); *In re Snyder*, 101 B.R. 822, 835 (Bankr. D. Mass. 1989) ("to summarize, the Court finds that the fiduciary duties of corporate directors under Massachusetts law satisfy the requirements of section 523(a)(4) of the Bankruptcy Code"), *aff'd in part & rev'd in part on other grounds sub nom. Bornstein v. Snyder*, 923 F.2d 840 (1st Cir. 1990); *see also In re Sullivan*, 217 B.R. 670, 676 (Bankr. D. Mass. 1998) ("Since *Snyder*, corporate officers and directors with fiduciary obligations under state law have consistently been found to be fiduciaries under § 523(a)(4)"); *In re Cummins*, 166 B.R. 338, 354 (Bankr. W.D. Ark. 1994) (holding that " a fiduciary relationship under section 523(a)(4) can be established is where there is a clear fiduciary duty on the part of corporate officers to a corporation with regard to the proper treatment of corporate assets over which the corporate officer has control"); *In re Jones*, 114 B.R. 917, 922 (Bankr. N.D. Ohio 1990) ("a corporate officer is a fiduciary of the corporation within the meaning of Sec. 523(a)(4)"); *In re Galbreath*, 112 B.R. 892, 898-900 (Bankr. S.D. Ohio 1990) (holding that "the fiduciary relationship occupied by a corporate (continued . . .)

3. There Is A Trust *Res* And A Beneficiary In This Case.

Defendant also contends that the "trust" requirements of Section 523(a)(4) are not satisfied because no trust "res" or trust "beneficiary" has been identified. *See* Def. Br. at 14:12-24. Once again, Defendant is wrong. *First*, courts have held that in cases such as this, in which a trust-type obligation is imposed pursuant to common-law, the trust res will be "implied" by the Court in order to give effect to the Section 523(a)(4). *See In re Stanifer*, 236 B.R. at 715 (holding that the "trust res is implied" in an action under Section 523(a)(4) brought against a fiduciary).

Second, and more importantly, there *is* an identifiable trust "res" in this case, namely, the assets of the Delaware Holding Company that Defendant permitted Araneta to divert for the personal use of the Araneta family. *See, e.g.*, Compl. Ex. A at *21 (holding that Defendant never bothered to "check whether the Delaware Holding Company retained *its primary assets* and never took any steps to recover the LBC Operating Companies once they realized that those assets were gone") (emphasis added). In these circumstances, it is the assets of the corporation itself that are considered the trust "res." *See, e.g.*, *Zachary Shultz*, 205 B.R. at 959 ("the Court finds Shultz, as a director of Miramar, was under a fiduciary obligation to the corporation for the management of the corporation and its assets, *which can be considered to constitute the* res *of a technical trust*") (emphasis added); *In re Sax*, 106 B.R. 534, 539 (Bankr. N.D. Ill. 1989) ("By agreeing to become a director of the Bank, Sweeney agreed to use the trust *res*, the Bank's resources, solely for the advantage of the Bank and not for any personal gain").

Moreover, although those assets belonged to the corporation in the first instance, ATR, as a minority shareholder, had an indirect ownership interest in them as well, at least to the

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(. . . continued)
director fall[s] within the scope of the term "fiduciary capacity" as it is used in Section 523(a)(4)"); *In re Cowley*, 35 B.R. 526, 528-29 (Bankr. D. Kan. 1983) ("it has long been settled that a corporate officer is a "fiduciary" of the corporation, within the meaning of § 523(a)(4) and § 17(a)(4), its predecessor section under the Bankruptcy Act of 1898"). For examples of cases holding to the contrary, see *In re Long*, 774 F.2d 875, 878-79 (8th Cir. 1985) and *In re Johnson*, 242 B.R. 283, 294 (Bankr. E.D. Pa. 1999).

extent that a diminution in the value of the assets would result in a corresponding diminution in the value of ATR's shareholdings. *See, e.g.*, Compl. Ex. A at *21 ("The major breach of fiduciary duty in this case is one that injured the Delaware Holding Company in the first instance and ATR secondarily as a minority stockholder"). Indeed, the Delaware court specifically described Plaintiffs' $3.922 million contribution to the Delaware Holding Company as an "investment" of "capital" in that company. *See, e.g.*, Compl. Ex. A at *21 (predicating the award "on the need to make ATR whole for the injury it suffered by entrusting its capital to the Delaware Holding Company"); *id.* at *4 ("[t]o protect *ATR's investment* in the LBC Operating Companies, the Undertaking Agreement granted ATR contractual protections . . .") (emphasis added); *id.* at *13 (discussing ATR's "minority equity investments"). And the Complaint itself alleges that "Bonilla failed properly to account for the investment ATR made in the Delaware Holding Company" by breaching his fiduciary obligations to them. *See* Compl. ¶75. Under these circumstances, there can be little doubt that the trust "res" in this case are the assets of the Delaware Holding Corporation, assets in which ATR had an indirect ownership interest as a minority shareholder and through its investment of capital.

Finally, as minority shareholders in the Delaware Holding Company, Plaintiffs were "beneficiaries" of the "trust res." *Cf. Arthur Shultz*, 208 B.R. at 729 ("pursuant to the Delaware Trust Fund Doctrine at the time of the July 20, 1991 meeting, the Defendant was a trustee of the corporation with the *res* being the corporate assets, [and] the beneficiary being the other directors *and the shareholders*") (emphasis added). To underscore the point, the Complaint in this litigation alleges that Defendant's "pre-existing fiduciary duties imposed upon [him] the responsibility for safeguarding the value of the assets of the Delaware Holding Company and, thereby, preserving the *value of ATR's interest as a minority shareholder* in the Delaware Holding Company." Compl. ¶73 (emphasis added); *see also id.* (alleging that Defendant failed "to take any steps to protect *ATR's interest* as a minority shareholder") (emphasis added). In a similar vein, the Delaware Court predicated its award "on the need to make ATR whole for the injury it suffered *by entrusting its capital* to the

Delaware Holding Company, only to see that corporation impoverished by the defendants." *Id.* Ex. A at *21 (emphasis added). These allegations and findings make explicit what should otherwise be obvious: Plaintiffs—minority shareholders in a company with only one other shareholder—were beneficial owners of the corporate assets, assets that had been entrusted to the directors of the corporation, including Defendant.

C. The *In re Shultz* Decisions.

1. The Decision In The *Zachary Shultz* Case Is Persuasive Precedent.

The *Zachary Shultz* case, 205 B.R. 952, is one of two[11] reported cases Plaintiffs have found discussing whether a Delaware director is a fiduciary for purposes of Section 523(a)(4) and is by far the most persuasive authority on this topic. The debtor in *Zachary Shultz*, like the debtor here, served as a director of a Delaware corporation (Miramar, Inc.) that had been improperly stripped of its assets. *Id.* at 954. Following liquidation of the corporation, a body of independent directors sued Zachary Shultz (and other members of the Shultz family who were also directors) on behalf of the corporation and obtained a judgment against him for breach of fiduciary duty. *Id.* After Zachary Shultz filed for bankruptcy, the corporation filed a non-dischargeability complaint and moved for summary judgment, seeking a declaration that the debt was non-dischargeable under Section 523(a)(4). The central issue before the Court was whether the debtor, as a corporate director of a Delaware corporation, was a "fiduciary" for purposes of Section 523(a)(4).

The Court held that he was. It began by examining the origins of the "trust" requirement in Section 523(a)(4), which it traced back to the Supreme Court's decision in *Davis v. Aetna Acceptance Co.*, 293 U.S. 328 (1934). There, the Supreme Court had held that

> [t]he statute [the predecessor of Section 523(a)(4)] speaks of technical trusts, and not those which the law implies from . . . contract. The scope of the exception [is] to be limited accordingly. . . . It is not enough that, by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee *ex maleficio*. He must have been a trustee before the

[11] The other reported case, *Arthur Shultz*, is discussed, *infra*.

> wrong and without reference thereto. . . . *The language would seem to apply only to a debt created by a person who was already a fiduciary when the debt was created.* (*Id.* at 333 (emphasis added))

The Court in *Zachary Shultz* next turned to the "numerous" decisions from around the country in which the issue of "fiduciary" duties under Section 523(a)(4) had arisen. *See Zachary Shultz*, 205 B.R. at 956-57 (discussing nine such cases). In each of these cases, save one, the Court found that the corporate director in question had been treated as a "fiduciary" for purposes of Section 523(a)(4). *See id.* The Court was particularly persuaded by *In re Snyder*, 101 B.R. 822 (Bankr. D. Mass. 1989) *aff'd in part & rev'd in part on other grounds sub nom. Bornstein v. Snyder*, 923 F.2d 840 (1st Cir. 1990), which held that the "'the operative language'" of Section 523(a)(4) is "'the requirement that [the statute] only applies to a debt created by a person who was already a fiduciary at the time the debt was created.'" *Zachary Shultz*, 205 B.R. at 958 (quoting *In re Snyder*, 101 B.R. at 835); *accord Matter of Marchiando*, 13 F.3d 1111, 1115-16 (7th Cir. 1994) ("The key to knitting the cases into a harmonious whole is the distinction stressed in *Davis* and other cases between a trust or other fiduciary relation that has an existence independent of the debtor's wrong and a trust or other fiduciary relation that has no existence before the wrong is committed. A lawyer's fiduciary duty to his client, *or a director's duty to his corporation's shareholders*, pre-exists any breach of that duty, while in the case of a constructive or resulting trust there is no fiduciary duty until a wrong is committed") (emphasis added).

Finally, the Court in *Zachary Shultz* turned to Delaware law. *See Zachary Shultz*, 205 B.R. at 958 ("Miramar is a Delaware corporation, and the Court will review Delaware law to ascertain whether a basis exists for finding Shultz's status as a director of Miramar imposed a fiduciary obligation sufficient to meet the strictures of §523(a)(4)"). On this point, the Court's decision was particularly insightful:

> Historically, Delaware courts have held corporate directors to high fiduciary standards and have even described the fiduciary obligation in terms of a trust. Directors of a corporation are spoken of as its trustees; their acts are scanned in the light of those principles which define the relationship existing between a trustee and a *cestui que trust*. . . . The law imposes upon the directors the duty of disposing of the shares in the interest of the corporation; the manner in which they perform that duty must meet the exacting standards required of a fiduciary

> acting in an office of trust and confidence . . . . More recent cases are in accord. Directors of a corporation stand in the position of trustees with their stockholders. *Petty v. Penntech Papers, Inc.*, 347 A.2d 140 (Del. Ch. 1975) (*Zachary Shultz*, 205 B.R. at 958-59) (citations omitted).

Based on these authorities, and on its finding that the fiduciary obligations at issue arose prior to the debt, the Court concluded that the debtor was a "fiduciary" for purposes of Section 523(a)(4) and that therefore his debt was non-dischargeable.[12] *Zachary Shultz*, 205 B.R. at 960 ("For the foregoing reasons, the Court grants summary judgment in favor of Miramar, Inc. and finds Zachary Shultz' debt to Miramar . . . is nondischargeable").

Here, as in *Zachary Shultz*, there is no dispute that Defendant's fiduciary obligations to Plaintiffs arose *prior to* the debt. In other words, this is not a case where Plaintiffs are seeking to rely on a constructive trust or a trust created "*ex maleficio*." *See, e.g.*, Compl. ¶73 ("In his capacity as Director of a Delaware corporation, Bonilla owed fiduciary duties to ATR, the Delaware Holding Company's minority shareholder, that predated the debt in this case"). And here, as in *Zachary Shultz*, the strictures of Delaware law imposed on the Defendant "trust-like" responsibilities in the discharge of his duties as a director. *See, e.g.*, *Hynson*, 601 A.2d at 575; *Petty*, 347 A.2d at 143; *In re Shoe-Town*, 1990 WL 13475, at *7; *Price v. Wilmington Trust Co.*, No. Civ. A. No. 12476, 1995 WL 317017, at *3 (Del. Ch. May 19, 1995). Finally, here, as in *Zachary Shultz*, the debtor breached those trust-like obligations by permitting the corporation to be stripped of its valuable assets. In short, *Zachary Shultz* is a powerful guide and persuasive authority for denying the pending motion to dismiss.

2. *Arthur Shultz* Is Not Persuasive Authority And Is Actually Rejected By Defendant Himself.

Arthur Shultz is the only other reported case Plaintiffs could find in which a bankruptcy court discussed whether a Delaware director was a "fiduciary" for purposes Section

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[12] As these citations to Delaware law make clear, the Court in *Zachary Shultz* did not "dispense" with the trust requirements of Section 523(a)(4) as Defendant accuses it of doing (*see* Def. Br. at 13:5-6), much less fail to provide a "cogent" analysis of how Delaware law imposes trust obligations on its directors. *See id.* at 10:9-11.

523(a)(4).[13] In that case, the Court also concluded that a Delaware director *was* a fiduciary for purposes of Section 523(a)(4). However, the Court reached that conclusion based not on the "trust-like" obligations imposed on directors under Delaware law, but rather on the "Delaware Trust Fund" doctrine, pursuant to which directors of a corporation that is insolvent or on the brink of insolvency owe trust obligations to the corporate enterprise. *See Arthur Shultz*, 208 B.R. at 729 (citing Delaware cases). Although Defendant asserts that *Arthur Shultz* was correctly decided as to the first issue, he is compelled to reject it as to the second. *Compare* Def. Br. at 10-11 (endorsing *Arthur Shultz*'s analysis of Delaware fiduciary law) *with* Def. Br. at 12-13 (attempting to show that *Arthur Shultz*'s analysis of the Delaware Trust Fund doctrine is incorrect). As even Defendant cannot fully embrace the decision in *Arthur Shultz*, this Court should also decline to do so.

There are, however, more substantive reasons for refusing to follow *Arthur Shultz*. Although the Court held that the debtor's position as a director "does not per se make him a trustee to the corporation" (*Arthur Shultz*, 208 B.R. at 729), its analysis lacked any real substance. In fact, it based its holding on a single quote to the effect that "'corporate officers and directors, while technically not trustees, stand in a fiduciary relation to the corporation and its stockholders.'" *Id.* at 729 (quoting *Bovay v. H.M. Byllesby & Co.*, 38 A.2d 808, 813 (Del. 1944)). The Court failed to delve any further into Delaware law, to examine any of the Delaware authorities cited above, to consider any other non-dischargeability cases involving corporate directors, or, most importantly, to consider whether the trust-like duties that are undeniably imposed on Delaware directors satisfy the "fiduciary" standard under Section

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[13]The two *Shultz* cases are related; Arthur Shultz and Zachary Shultz were brothers and co-directors of the Delaware corporation at issue, Miramar, Inc. *See Zachary Shultz*, 205 B.R. at 954. Each Shultz brother filed for Chapter 7 bankruptcy protection, one (Zachary) in New Mexico and the other (Arthur) in Florida.

In addition, the Shultz's father and co-director, William Shultz, Sr., also filed for bankruptcy. In an unreported decision (which Plaintiffs have been unable to obtain), the Bankruptcy Court for the Northern District of Texas apparently agreed with *Zachary Shultz* and concluded that William Shultz's debt was also non-dischargeable under Section 523(a)(4). *See Arthur Shultz*, 208 B.R. at 726 n.2 (noting that the Texas court had granted "the Plaintiffs Motion for Summary Judgment in the Case involving William Shultz, Sr.").

523(a)(4). Moreover, the Court did not examine or consider the rationale of the earlier-decided *Zachary Shultz* decision, much less attempt to show that it was wrong. On the contrary, the Court appeared to accept the holding in *Zachary Shultz* and, in a conclusory footnote, simply distinguish it on the ground that the findings against Zachary Schultz indicated a "larger participation" by him than by his brother, Arthur. *See Arthur Shultz*, 208 B.R. at 726 n.2. Thus, analysis is altogether lacking.

The reason for the lack of analysis in *Arthur Shultz* is apparent: such analysis was unnecessary. Because the Court decided that the debtor was a "fiduciary" under Section 523(a)(4) *on alternative grounds*—namely, the applicability of the "Delaware Trust Fund" doctrine (*see Arthur Shultz*, 208 B.R. at 729-30)—it had no reason to engage in a searching exploration of Delaware fiduciary law or to reconcile its decision with *Zachary Shultz*. In the end, this failure of analysis militates strongly against using *Arthur Shultz* as a precedent for determining whether Defendant was a "fiduciary" under Section 523(a)(4).

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CONCLUSION

For the reasons given above, the Court should deny Defendant's motion to dismiss the Fourth Claim for Relief. Viewing the facts alleged in the Complaint, together with its attachments, in the light most favorable to Plaintiffs, it is apparent that Defendant has not and cannot demonstrate that the Fourth Claim for Relief fails to state a claim upon which relief can be granted.

DATED: September 14, 2007.

Respectfully,

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN
A Professional Corporation

By: _____
WILLIAM J. LAFFERTY

Attorneys for Plaintiffs ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC.

Entered on Docket
October 16, 2007
GLORIA L. FRANKLIN, CLERK
U.S BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

Signed and Filed: October 16, 2007

THOMAS E. CARLSON
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re HUGO NERY BONILLA, Debtor.	Case No. 07-30309 TEC Chapter 7
ATR-KIM ENG CAPITAL PARTNERS, INC., and ATR-KIM ENG FINANCIAL CORPORATION, Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	Adv. Proc. No. 07-3079 TC

ORDER DENYING DEFENDANT'S MOTION TO DISMISS PLAINTIFFS' FOURTH CLAIM FOR RELIEF

On September 28, 2007, the court held a hearing on Defendant's Motion to Dismiss Plaintiffs' fourth claim for relief. Iain A. Macdonald appeared for Defendant. William J. Lafferty appeared for Plaintiffs.

EXHIBIT E

Upon due consideration, and for the reasons stated in the accompanying memorandum, Defendant's motion is denied.

****END OF ORDER****

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CERTIFICATE OF SERVICE

District/off: 0971-3 User: dchambers Page 1 of 1 Date Rcvd: Oct 16, 2007
Case: 07-03079 Form ID: pdfeoapc Total Served: 2

The following entities were served by first class mail on Oct 18, 2007.
+Michael C. Fallon, Esq., Law Offices of Michael C. Fallon, 100 E Street, Suite 219, Santa Rosa,, CA 95404-4606
+Michael J. Baker, Esq., William J. Lafferty, Esq., Matthew L. Beltramo, Esq., Howard, Rice, Nemerovski, Canady, et. al, Three Embarcadero Center, 7th Floor, San Francisco, CA 94111-4078

The following entities were served by electronic transmission.
NONE. TOTAL: 0

***** BYPASSED RECIPIENTS *****
NONE. TOTAL: 0

Addresses marked '+' were corrected by inserting the ZIP or replacing an incorrect ZIP.
USPS regulations require that automation-compatible mail display the correct ZIP.

I, Joseph Speetjens, declare under the penalty of perjury that I have served the attached document on the above listed entities in the manner shown, and prepared the Certificate of Service and that it is true and correct to the best of my information and belief.

First Meeting of Creditor Notices only (Official Form 9): Pursuant to Fed. R. Bank. P. 2002(a)(1), a notice containing the complete Social Security Number (SSN) of the debtor(s) was furnished to all parties listed. This official court copy contains the redacted SSN as required by the bankruptcy rules and the Judiciary's privacy policies.

Date: Oct 18, 2007 **Signature:** Joseph Speetjens

UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re HUGO NERY BONILLA, Debtor.	Case No. 07-30309 TEC Chapter 7
ATR-KIM ENG CAPITAL PARTNERS, INC., and ATR-KIM ENG FINANCIAL CORPORATION, Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	Adv. Proc. No. 07-3079 TC

MEMORANDUM RE DEFENDANT'S RULE 12(b)(6) MOTION

Plaintiff obtained a $24.5 million judgment against Defendant in Delaware state court. That court found that Defendant, a corporate director, breached his duty of loyalty to Plaintiff, a minority shareholder, by failing to take any steps to monitor the operations of the corporation. The Delaware court held Defendant liable for the loss Plaintiff suffered when the majority

EXHIBIT F

shareholder transferred to himself substantially all of the corporation's assets.

In the present action, Plaintiff seeks a determination that Defendant's liability is nondischargeable under 11 U.S.C. § 523(a)(4), because it arises from "defalcation while acting in a fiduciary capacity". Defendant moves to dismiss that claim for relief, contending that a corporate director is not a "fiduciary" under section 523(a)(4).[1] For the reasons set forth below, the motion is denied.

Whether a debtor is a fiduciary within the meaning of section 523(a)(4) is a question of federal law. Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996). First, the debtor must have been subject to the duties of a trustee before, and without reference to, the wrongdoing that gave rise to the debt. Id. Second, the duties imposed on the debtor must be those imposed on the trustee of an express or technical trust. Id. at 1185-86 n.1. Thus, there must be an identifiable trust *res*, identifiable beneficiaries, and the debtor must be subject to the duties of loyalty, good faith, and honesty in caring for the trust *res*. Lewis, supra, 97 F.3d at 1186 n.1; Miramar Resources, Inc. v. Shultz (In re Shultz), 208 B.R. 723, 728 (Bankr. M.D. Fla. 1997)(Shultz II).

Whether a debtor is subject to the duties just described is primarily a matter of state law. Lewis, supra, 97 F.3d at 1185. The requisite duties can be imposed by agreement, state statute, or

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[1] Plaintiff is not urging that the decision of the Delaware court be given issue-preclusive effect at this time. The findings of fact in the state-court decision are treated as allegations for the purpose of the present motion.

state case law. Id. at 1185-86. The parties here agree that Delaware law defines Defendant's duties as a corporate director.

Numerous Delaware decisions refer to directors as trustees, and impose on directors the highest duties of loyalty, honesty, and fair dealing in all matters concerning the management of corporate assets. See, e.g., Hynson v. Drummond Coal Co., Inc., 601 A.2d 570 (1991); Keenan v. Eshleman, 2 A.2d 904, 908 (1938). Furthermore, Delaware cases impose this fiduciary duty prior to, and without reference to, any misconduct by the director.

> It is not always necessary for [directors] to reap a personal profit or gain a personal advantage in order for their actions in performance of their quasi trust to be successfully questioned. Trustees owe not alone the duty to refrain from profiting themselves at the expense of their beneficiaries. They owe the duty of saving their beneficiaries from loss.

Bodell v. General Gas & Electric Corp., 132 A. 442, 447 (1926). Thus, Delaware case law clearly identifies the fiduciary duties of a corporate director, the trust *res* (all corporate assets), and the beneficiaries of the trust (the corporation and its shareholders).

Delaware court decisions do not, however, equate corporate directors with trustees in all respects. The Bodell decision quoted above refers to directors as "quasi" trustees. Id. Another Delaware decision notes that trustees differ from corporate directors in that trustees usually occupy a caretaking role, while directors are often required to take risks with the assets they manage. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1148 (1994). Yet another Delaware decision states that corporate directors are not trustees in the strictest sense, because they do not hold legal title to the property of the corporation.

> The officers and directors of a corporation are fiduciaries but they are not real trustees. They do not hold the legal title to the corporate property. They occupy a position of extreme trust and confidence toward all interested parties, and exercise great powers in managing corporate affairs, but they are not trustees of an express trust in the true sense of that term.

Bovay v. H.M. Byllesby & Co., 29 A.2d 801, 804 (1943) (citations omitted); see also Shultz II, supra, 208 B.R. at 729 (Delaware courts say directors are fiduciaries but "technically not trustees"). The major authorities on trust law are in accord that corporate directors occupy a trust-like position, but are not trustees in the strict sense, because they do not directly hold legal title for a beneficial owner. Bogert & Bogert, Law of Trusts & Trustees § 16 (2007); accord Restatement (Third) of Trusts §§ 2, 5(g) (2003).

The Ninth Circuit states "the fiduciary relationship must be one arising from an *express or technical trust* that was imposed before and without reference to the wrongdoing that caused the debt." Lewis, supra, 97 F.3d at 1185 (emphasis added). Does this mean that in addition to preexisting the wrong, the fiduciary duty must be identical to that of a trustee in every technical respect?

I conclude that the fiduciary duty must preexist the trust, and must be *substantially similar* to the role of a trustee, in that there must be a trust *res*, identifiable beneficiaries, and clear notice of the duties of loyalty, honesty, and fair dealing toward the beneficiaries in all matters affecting the trust *res*. In Lewis, the Ninth Circuit found partners to be fiduciaries under section 523(a)(4) upon the basis of state-court decisions that imposed on partners the duties of loyalty, honesty, and fair dealing. Id. at 1186. One of the decisions Lewis relied upon

described the duties of a partner as merely "similar to a trustee's," and the other decisions cited failed to use the term trustee at all in describing the duties of a partner.[2] In addition, Lewis noted with approval language in Collier stating that the duties of the fiduciary need only be "substantially similar" to those imposed on trustees.

> "If state law clearly and expressly imposes trust obligations on managing partners of limited partnerships substantially similar to those imposed on trustees, i.e., the duty of loyalty and the duty to deal with one another in good faith and with honesty, these fiduciary obligations meet the strict requirements of section 523(a)(4)".

Id. at 1186 n.1.

As noted above, the director of a corporation organized under Delaware law is subject to duties substantially similar to those imposed on the trustee of an express or technical trust, and those duties arise before and without reference to any wrongdoing. The director of a Delaware corporation is therefore a fiduciary within the meaning of section 523(a)(4). Miramar Resources, Inc. v. Shultz (In re Shultz), 205 B.R. 952, 959 (Bankr. D. New Mex. 1997) (Shultz I); see Foster v. Lasagna, 609 F.2d 392, 396 (9th Cir. 1979)(director of corporation organized under California law is a fiduciary for purpose of section 523(a)(4)); see also Nahman v. Jacks (In re Jacks), 266 B.R. 728, 737 (9th Cir. BAP 2001)(same).

Defendant also argues that the Delaware judgment imposes liability on him for acts that should be protected under the business judgment rule. In essence, this is an argument that the

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[2] Desantis v. Dixon, 236 P.2d 38, 41 (Ariz. 1951) (does not refer to partner as trustee); Jerman v. O'Leary, 701 P.2d 1205, 1210 (Ariz. App. 1985)(same); Carrasco v. Carrasco, 422 P.2d 411, 413 (Ariz. App. 1967) (duty of partner "similar to a trustee's").

facts alleged do not amount to a "defalcation" within the meaning of section 523(a)(4). A defalcation generally does not include the poor exercise of business judgment in carrying out an act that the fiduciary was authorized to perform. Blyler v. Hemmeter (In re Hemmeter), 242 F.3d 1186, 1191 (9th Cir. 2001).

The facts alleged here, however, constitute a complete failure to take any action to preserve the assets of the corporation, and therefore go well beyond the poor exercise of business judgment. The Delaware court found:

> Bonilla . . . acted as . . . [a] stooge for Araneta, seeking to please him and only him, and having no regard for [Bonilla's] obligations to act loyally towards the corporation and all of its stockholders. Such behavior is not indicative of a good faith error in judgment; it reflects a conscious decision to approach one's role in a faithless manner by acting as a tool of a particular stockholder, rather than as an independent and impartial fiduciary honestly seeking to make decisions for the best interests of the corporation. . . . When required by [Bonilla's] office to be loyal to the Delaware Holding Company, Bonilla . . . chose total fealty to Araneta's conflicting interests instead.

ATR-Kim Eng Financial Corp. v. Araneta, 2006 WL 3783520 at 1, 21 (Del. Ch. 2006). Defendant's alleged acts are less like an unfortunate choice in the purchase of stock than they are like leaving a large amount of cash unguarded in a public place. As such, the alleged facts represent the type of failure to account for trust property that has traditionally been the hallmark of defalcation. Otto v. Niles (In re Niles), 106 F.3d 1456, 1460-62 (9th Cir. 1997).

****END OF MEMORANDUM****

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UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In Re: HUGO NERY BONILLA, Debtor.	Case No. 07-30309 Chapter 7 Adv. Proc. No. 07-03079 MOTION TO RECONSIDER ORDER DENYING DEFENDANT'S MOTION TO DISMISS PLAINTIFF'S FOURTH CLAIM FOR RELIEF Date: December 14, 2007 Time: 9:30 a.m. Place: 235 Pine Street Courtroom No. 23 San Francisco, CA (Judge Carlson)
ATR-KIM ENG FINANCIAL CORPORATION AND ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	

INTRODUCTION

Defendant Hugo Nery Bonilla hereby moves for relief under Rule 59 of the Federal Rules of Civil Procedure, incorporated by Bankruptcy Rule 9023, and requests that the court reconsider and vacate its order denying Bonilla's motion to dismiss ATRs fourth claim for relief, entered on October 16, 2007, in order to correct manifest errors of law, as follows:

First, this court committed manifest error of law by ruling that Delaware law imposes fiduciary duties on corporate directors which are "substantially similar" to those held by trustees of express or technical trusts. But Delaware law unambiguously *limits imposition of trustee duties* on

EXHIBIT G

its corporate directors to certain circumstances, such as when a corporation becomes insolvent or when directors have profited from breaches of their duties. Moreover, the court's ruling cites no Delaware law imposing higher duties on its corporate directors outside of the insolvency or wrongdoing exceptions. Accordingly, even under this court's own "substantially similar" test, which is not the law of the Ninth Circuit, Bonilla was not a fiduciary under § 523(a)(4).

Second, this court erred committed manifest error of law by relying upon the matter of *Lewis v. Scott (In re Lewis)*, 97 F.3d 1182 (9th Cir. 1996), which ruled that Arizona *partners* are fiduciaries under § 523(a)(4), rather than the Ninth Circuit's more relevant and recent decision in matter of *In re Cantrell*, 329 F.3d 1119 (9th Cir. 2003), which held that California corporate *directors* are not fiduciaries under § 523(a)(4) and refuted the applicability of prior case law holding that partners are fiduciaries under § 523(a)(4). Significantly, the *Cantrell* court did not analyze whether California corporate directors have duties which are "substantially similar" to those of a trustee of an express or technical trust. Instead, *Cantrell* is grounded in clear authority from California's highest state court that "strictly speaking, the relationship [between corporate officers and directors and the shareholders] is not one of trust, but of agency." *Cantrell* at 1126. Considering that both ATRs and Bonilla's briefs discuss *Cantrell*, it is not clear why the court overlooked this important decision.

This court's ruling also commits manifest error of law because it goes beyond the holding of *Lewis*. *Lewis* closely mirrors *Ragsdale v. Haller*, 780 F.2d 794 (9th Cir. 1986), in which the Ninth Circuit found that under California law, all partners are trustees over the assets of the partnership and thus, that California partners are fiduciaries under § 523(a)(4). *Lewis* found *uncontroverted* Arizona state partnership law using language similar to California state partnership law and imposing heightened fiduciary duties on Arizona partners. *Lewis* at 1186. Neither *Ragsdale* nor *Lewis* discuss state law holding that partners are "technically not partners" or are "quasi-partners" to each other.

Lewis did not assert that it was expanding the Ninth Circuit's requirements under § 523(a)(4) by adopting a "substantially similar" test, which is notable given that expanding the definition of "fiduciary" as set down by the United States Supreme Court more than 100 years ago would be a radical departure from this Circuit's law. Moreover, it is notable that *no other cases* from the Ninth Circuit since *Lewis* have applied a "substantially similar" test. Rather, Ninth Circuit cases continue

to narrowly construe § 523(a)(4) by requiring that fiduciary duties must have been imposed pursuant to an express or technical trust.

Accordingly, this court's decision to adopt a "substantially similar" test is an error of law which radically departs from the law of this Circuit. Thus, grounds for reconsideration exist to reconsider and reverse this court's order denying Bonilla's motion to dismiss ATRs fourth claim for relief.

HISTORY OF ACTION

On August 31, 2007, Bonilla filed a motion to dismiss ATRs fourth claim for relief, arguing that ATR's complaint fails to state a claim upon which relief may be granted under § 523(a)(4) because ATR did not and could not set forth facts that Bonilla was a fiduciary pursuant to an express trust or technical trust. Memorandum of Points and Authorities Supporting Motion to Dismiss Complaint ("Memo. Mtn. Dismiss"). Specifically, Bonilla's duties to ATR as a corporate director fell within the realm of the broad and general definition of a fiduciary, which are not sufficient to support a § 523(a)(4) claim.

ATR opposed the motion, arguing that "trust-like" duties imposed by state common-law are sufficient to establish a claim under § 523(a)(4). Memorandum of Points and Authorities in Opposition to Defendant's Motion to Dismiss Fourth Cause of Action Pursuant to Federal Rule of Civil Procedure 12(b)(6) ("Opp.") at 11-12. ATR stated that its "trust-like duties" test is supported by the *Lewis* decision and that Delaware law imposes trust-like duties on its corporate directors. Opp. at 12:8-25, 12:28-16:14. ATR distinguished the *Cantrell* decision which determined that California corporate directors are not fiduciaries under § 523(a)(4), on the grounds that duties imposed on California corporate directors are grounded in agency law. Opp. at 14 n.7. In contrast, the duties imposed on Delaware corporate directors are grounded in trust law. Opp. at 14 n.7. ATR failed to explain that *Cantrell* did not make this distinction. Opp. at 14 n.7. Further, although the *Cantrell* court "relied on language from California cases to the effect that directors are 'technically not trustees' ... that language came from Delaware common law." Opp. at 14 n.7.

Bonilla's reply brief refuted ATRs arguments, distinguishing *Lewis* on two grounds. First, *Lewis* pertains to partners, who, in comparison with corporate directors, "are directly liable to each

other to account for partnership property" and whose responsibilities and duties are different from corporate directors in several material respects. Reply in Support of Motion to Dismiss Complaint ("Reply") at 10:13-22, 12:28-13:16. Second, *Cantrell* refused to extend its rationale in *Ragsdale* and *Lewis* to corporate directors. Reply at 10:23-11:6, 11 n.10.

On September 27, 2007, the court issued a tentative order granting Bonilla's motion to dismiss. Tentative Ruling Re Motion to Dismiss § 523(A)(4) Claim ("Tentative Ruling"). In its tentative ruling, the court correctly found that Delaware state law does not impose either express or technical trust duties upon corporate directors. Tentative Ruling at 1:22-2:2. Further, a technical trust does not apply because corporate directors do not hold title to the corporation's property. Tentative Ruling at 2:2-9 (citing Bogert & Bogert, The Law of Trusts & Trustees § 16 (2007).

On September 28, 2007, the parties appeared before the court to argue the motion. On behalf of ATR, William Lafferty, Esq. admitted that an express or technical trust did not exist to impose fiduciary duties on Bonilla. Instead, he argued that denying Bonilla's motion would further bankruptcy policy. Lafferty urged the court to adopt the reasoning of bankruptcy court decisions which apply the "substantially similar" test, and stated that he believes that the law is headed in that direction. Finally, Lafferty urged the court to consider the matter of *Woodstock Housing Corp., Plaintiff v. Felicia Johnson (In re Johnson)*, 242 B.R. 283 (Bankr. E.D. Penn. 1999). The court took the matter under submission.

On October 16, 2007, the court issued its order, reversing its tentative ruling and denying Bonilla's motion to dismiss. Order Denying Defendant's Motion To Dismiss Plaintiff's Fourth Claim For Relief. The court's findings are set forth in its Memorandum Re Defendant's Rule 12(b)(6) Motion ("Memo."). The court appears to have changed its mind since its tentative ruling upon further review of the parties' briefs rather than upon consideration of Lafferty's arguments at the hearing, as the Memorandum does not discuss the issues mentioned by Lafferty at the hearing.

The Memorandum appears to state that Delaware law is in conflict on the issue of whether a corporate director is a trustee: while the court found that "numerous Delaware decisions refer to directors as trustees", the court also found that "Delaware court decisions do not, however, equate corporate directors with trustees in all respects." Memo. at 3:3-4, 3:18-19. The only decision cited

from Delaware's highest court is *Keenan v. Eshleman*, 23 Del.Ch. 234, 2 A.2d 904, 908 (Del. 1938) in which the Delaware Supreme Court states that defendant corporate officers are trustees. But this court's Memorandum fails to address the fact that subsequent authority from the Delaware Supreme Court, *Bovay v. H.M. Byllesby & Co.*, 27 Del.Ch. 381, 393, 38 A.2d 808 (1944), clarified that directors are not trustees, but that under limited circumstances, such as upon a corporation's insolvency or, as in the *Keenan* matter, upon their wrongdoing, directors may be imposed with trustee duties. This court does not cite Delaware law imposing higher or trustee duties on its corporate directors outside of the insolvency or wrongdoing exceptions.

In support its decision to adopt the "substantially similar" test, this court relied upon *In re Lewis*, 97 F.3d 1182. Memo. at 4:24-5:11. The Memorandum states that *Lewis* was grounded in "state-court decisions that imposed on partners the duties of loyalty, honesty, and fair dealing," case law describing a partner's duties as similar to a trustee's, and statements in COLLIER ON BANKRUPTCY that "the duties of the fiduciary need only be 'substantially similar' to those imposed on trustees." Memo. at 4:2r-5:11. But by relying so heavily on *Lewis*, this court overlooked several material facts, namely: (1) that *Lewis* does not state that pursuant to its decision, the Ninth Circuit is now deviating from its established, narrow interpretation of "fiduciary" under § 523(a)(4) by adopting a more expansive "substantially similar" test; (2) that even if Lewis adopted a "substantially similar" test, then *Lewis* is an anomaly in the Ninth Circuit, as no other Ninth Circuit case has applied this test; (3) that *Cantrell*, discussed in both parties' briefs, refused to extend its decisions pertaining to partners under § 523(a)(4) to corporate directors; (4) that *Lewis* simply followed its decision in *Ragsdale v. Haller* to fiduciary status on partners under § 523(a)(4); and (5) that *Lewis* was grounded on uncontroverted Arizona partnership state law.

THE BANKRUPTCY COURT'S ORDER DENYING BONILLA'S MOTION TO DISMISS COMMITS MANIFEST ERRORS OF LAW BECAUSE DELAWARE DOES NOT IMPOSE FIDUCIARY DUTIES ON CORPORATE DIRECTORS WHICH ARE "SUBSTANTIALLY SIMILAR" TO THOSE OF A TRUSTEE AND BECAUSE THE COURT'S ADOPTION OF THE "SUBSTANTIALLY SIMILAR" TEST RADICALLY DEPARTS FROM NINTH CIRCUIT PRECEDENT DEFINING "FIDUCIARY" UNDER §523(A)(4)

Pursuant to Rule 9023 of the Federal Rules of Bankruptcy Procedure and Rule 59(e) of the Federal Rules of Civil Procedure, the court may reconsider its decision in order to correct a manifest

error of law. *In re Gutterman*, 239 B.R. 828, 830 (Bankr. N.D. Cal. 1999)(denying a motion by the United States Trustee for reconsideration of the court's order granting the application of the debtors' counsel for nunc pro tunc employment). A motion to reconsider "must be filed no later than 10 days after entry of the judgment." Fed. R. Civ. Proc. 59(e).

A. The Motion To Reconsider Is Timely

This motion to reconsider is timely. The court's order was entered on October 16, 2007, and this motion is filed ten days later, on October 26, 2007.

B. The Court Erred In Finding That Delaware Law Imposes Fiduciary Duties "Substantially Similar To Those Of The Trustee Of An Express Or Technical Trust" Because Delaware Law *Limits* Imposition Of Trustee Duties To Circumstances Where The Corporation Is Insolvent Or Where The Directors Unlawfully Profited From Their Breach Of Duty

This court incorrectly ruled and thus committed manifest error of law by ruling that under Delaware law, a corporate director "is subject to duties substantially similar to those imposed on the trustee of an express or technical trust." In fact, Delaware law does not impose trustee duties on corporate directors unless the corporation is insolvent or in circumstances of wrongdoing by the directors. Moreover, this court does not cite, nor is there any authority that Delaware corporate directors have generally have higher fiduciary duties (outside of the insolvency or bad faith circumstances) which are similar to those of a trustee.

The only case cited in this court's decision from Delaware's highest court, the Delaware Supreme Court, is *Keenan v. Eshleman*, 23 Del.Ch. 234, 2 A.2d 904, 908 (Del. 1938), which imposed liability on corporate officers for their role in fraudulently paying management fees to the managing corporation. But as explained in the Delaware Supreme Court's subsequent holding, *Bovay v. H.M. Byllesby & Co.*, 27 Del.Ch. 381, 393, 38 A.2d 808 (Del. 1944), under Delaware law, directors are in fact *not trustees*, but may become trustees under certain circumstances, such as upon a corporation's insolvency or, as was the case in *Keenan*, upon wrongdoing by the directors. The *Bovay* court explained that:

> Clearly, it was not meant that directors of a corporation are trustees, in a strict and technical sense, in all their relations with the corporation, its stockholders and creditors; but, as clearly, it was implied that they should be treated as such when they have unlawfully profited

through breach of duty, and at the expense of the corporation.

Bovay v. H.M. Byllesby & Co., 27 Del.Ch. 381, 393. The *Bovay* court explained that its decision to impose trustee status on the defendant officers in *Guth v. Loft, Inc.*, 23 Del.Ch. 255, 5 A.2d 503, 510, was based on similar circumstances of wrongdoing. *Bovay v. H.M. Byllesby & Co.*, 27 Del.Ch. 381, 393-94.

This court extensively analyzed Delaware law and *Bovay* in the matter of *Decker v. Mitchell (In re JTS Corp.)*, 305 B.R. 529, 536-40 (Bankr. N.D. Cal. 2003). *In re JTS Corp.* described the occasions where Delaware law imposes heightened fiduciary duties on its corporate directors as the "trust fund doctrine" and the "insolvency exception," and explained that neither doctrine truly creates a trust, but are used by the Delaware courts as equitable remedies. *In re JTS Corp.* at 536-40. *In re JTS Corp.* ruled that under Delaware law, a corporation's insolvency imposes upon directors a fiduciary relationship to the corporation's creditors, which "is certainly one of loyalty, trust and confidence, but it does not involve holding the insolvent corporation's assets in trust for distribution ..." *Id.* at 539. *In re JTS Corp.* further found that while *Bovay* ruled that Delaware law "will treat directors of corporations as trustees when directors have taken 'such advantage of their position of trust as public policy could not tolerate'", subsequent Delaware law has not followed an uncompromising trust fund doctrine. *In re JTS Corp.* at 538. Thus, even under Delaware's trust fund doctrine and the insolvency exception, Delaware does not impose fiduciary duties on directors pursuant to express or technical trust.

The Memorandum also did not cite Delaware authority which generally imposes heightened duties on corporate directors. Indeed, as stated in *Prof'l Hockey Corp. v. World Hockey Ass'n* (1983) 143 Cal. App. 3d 410, 414, California and Delaware impose identical fiduciary duties on their directors:

> Delaware law adopts, as has California, the concept of the directors and/or trustees fiduciary duty (*Guth* v. *Loft, Inc.* (1939) 23 Del.Ch. 255, 5 A.2d 503), including the duties of obedience, diligence and loyalty. Directors owe such duty in the management of corporate affairs. In performance of their official duties directors are under obligations of trust and confidence to the corporation and its stockholders. Directors must act in good faith for the interests of the corporation or its stockholders with due care and diligence and within the bounds of their authority. It is the duty of the director to see that a corporation keeps within its corporate powers and obeys the laws. (19 Am.Jur.2d Corporations, § 1271, p. 677.) Under

both California and Delaware law the duty of loyalty requires the directors/trustees not to act in their own self-interest when the interest of their corporation will be damaged thereby.

Thus, Delaware law does not impose fiduciary duties on corporate directors which are "substantially similar" to those imposed on a trustee pursuant to an express or technical trust. Instead, Delaware imposes heightened fiduciary and trustee duties on directors in limited circumstances and pursuant to a constructive trust or *ex maleficio*, neither of which are included within the purview of § 523(a)(4). See *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986). Accordingly, Delaware directors are not fiduciaries under § 523(a)(4). Thus, this court committed manifest error in ruling that Delaware law imposes trustee duties on its corporate directors and that Bonilla was thus a fiduciary under § 523(a)(4).

C. The Court Erred In Relying On *In Re Lewis* And In Overlooking *In Re Cantrell*, Which Held That Corporate Directors Are Not Fiduciaries Under § 523(a)(4)

This court erred in relying upon the matter of *In re Lewis*, 97 F.3d 1182, which pertains to whether *partners* are fiduciaries under § 523(a)(4), while overlooking and failing to distinguish the more relevant and current decision from the Ninth Circuit, *In re Cantrell*, 329 F.3d 1119,[1] which pertains to whether *corporate officers and directors* are fiduciaries under § 523(a)(4). Notably, *Cantrell* did not apply a "substantially similar" test to determine whether the defendant was a fiduciary under § 523(a)(4). Instead, *Cantrell* determined that California corporate directors are not fiduciaries under § 523(a)(4) because California law, specifically the California Supreme Court's

[1] In response to Lafferty's assertion that the direction of the courts is to apply the "trust-like" duties test under § 523(a)(4), and in response to ATR list of cases at page 17 n.10 of its opposition brief which hold that corporate directors are fiduciaries under § 523(a)(4)(nearly all of which are more than 10 years old), the following is a list of a few recent cases which *do not hold* that directors are fiduciaries under § 523(a)(4): *Fain v. Webb (In re Webb)*, 349 B.R. 711, 717 (Bankr. Or. 2006)("Under Oregon law, a director and officer has a fiduciary obligation to the corporation, and, by extension, to the corporation's creditors and shareholders. However, this is not the sort of fiduciary relationship contemplated by § 523(a)(4)"); *Dominie v. Jones (In re Jones)*, 306 B.R. 352, 357 (Bankr. N.D. Ala. 2004)("the duties owed by a corporate officer and controlling shareholder in a closely-held corporation to another officer and minority shareholder are not those of a fiduciary within the meaning of § 523(a)(4)"); *Digital Commerce, Ltd. v. Sullivan (In re Sullivan)*, 305 B.R. 809, 825 (Bankr. W.D. Mich. 2004)(Michigan officers and directors are trustees with respect to corporate assets and thus are not fiduciaries under § 523(a)(4)); *Cal-Micro, Inc. et al v. Cantrell (In re Cantrell)*, 329 F.3d 1119 (9th Cir. 2003)(under California law, a corporate officer is not a "fiduciary" within the meaning of § 523(a)(4)); *Florida Dep't of Ins. v. Blackburn (In re Blackburn)*, 209 B.R. 4 (Bankr. M.D. Fla. 1997)(the general fiduciary duties owed to a corporation by its officers and directors are insufficient, by themselves, to support a claim that the officers and directors stand in a "fiduciary capacity" to the corporation for purposes of § 523(a)(4));

decision in the matter of *Bainbridge v. Stoner*, 16 Cal. 2d 423, 106 P.2d 423 (Cal. 1940), holds that corporate directors are not trustees. *In re Cantrell*, at 1126-27. *Bainbridge* ruled that directors are not trustees despite the fact that directors were required to comply with § 2230 of the Civil Code, forbidding trustees from taking part in transactions concerning the trust which are adverse to the beneficiary. *Id.* at 428.

Cantrell distinguished several California cases stating that directors are trustees. *Id.* at 1126 n.4, 1128. First, *Cantrell* found that *Interactive Multimedia Artists, Inc. v. Superior Court*, 62 Cal. App. 4th 1546 (1998), which states that "'the fiduciary duty of a controlling shareholder or director to a minority shareholder is based on 'powers in trust'", is inapplicable because "this language is ambiguous and could simply mean that directors and controlling shareholders have a general fiduciary duty to act fairly with respect to corporate matters." *Cantrell*, at 1126 n.4. Further, *Interactive Multimedia* did not mention *Bainbridge* and it is not likely that the *Interactive Multimedia* court intended to contradict the state's highest court. *Id.* Next, the *Cantrell* court dismissed the applicability of statements made in pre- *Bainbridge* cases. *Id.* "[T]he California Supreme Court's ambiguous holding in *Bainbridge* that directors and officers are not trustees with respect to corporate assets is the precedent that we must follow." *Id.*

Cantrell also distinguished *Ragsdale v. Haller (In re Ragsdale)*, 780 F.2d 794 (9th Cir. 1986), which ruled that "'California partners are fiduciaries within the meaning of § 523(a)(4).'" *Cantrell* at 1127, citing *In re Ragsdale*, 780 F.2d at 796-97. The *Ragsdale* court's holding was grounded in "several California cases that 'raised the duties of partners beyond those required by the literal wording' of the California partnership statute." *Cantrell*, at 1127, citing *In re Ragsdale*, at 796. But whether California law holds that partners are trustees is not significant because of the *Bainbridge* court's clear holding and because "California corporate law simply does not provide the same trust relationship between corporate principals and the corporation." *Cantrell*, at 1127.

This court's ruling does not accord with *In re Cantrell* because, as explained herein, Delaware law does not impose trustee duties on its corporate directors. Instead, the Delaware Supreme Court clearly holds that trustee duties are imposed in limited circumstances under either a constructive trust or *ex maleficio*.

D. This Court's Ruling Radically Deviates From Established Ninth Circuit Precedent By Expanding The Definition Of Fiduciary Within The Meaning Of § 523(a)(4)

The court's "substantially similar" test deviates from established, historical and clear authority from the United States Supreme Court and the Ninth Circuit and thus this court's adoption of the test constitutes a manifest error of law. First, if this court bases its new test on *Lewis*, then it is notable that *Lewis* did not state that it was adopting a "substantially similar" test, given that the test expands on Ninth Circuit precedent, which narrowly construes § 523(a)(4). Adoption of this test without explanation is also inexplicable since *Lewis* acknowledged that "the fiduciary relationship must be one arising from an express or technical trust." *Lewis*, at 1185. It is unlikely that the Ninth Circuit would have expanded the definition of "fiduciary" under § 523(a)(4), set down more than 150 years ago by the United States Supreme Court in *Chapman v. Forsyth*, 43 U.S. 202, 205, 11 L.Ed. 236 (1844), without explaining why it decided to adopt such a radical departure from the law. Rather, *Lewis* appears to have mirrored the reasoning set forth in *Ragsdale*, that partners are fiduciaries to each other under § 523(a)(4) based on clear state law.

Second, if *Lewis* adopted a "substantially similar" test, then it is an anomaly in this Circuit, as no Ninth Circuit case has followed *Lewis* for this premise, and the United States Supreme Court had certainly not adopted this expanded definition of fiduciary. Instead, as evidenced by *Cantrell*, Ninth Circuit cases continue to comply with the express or technical trust requirement. Accordingly, it is clear that this court's order denying Bonilla's motion to dismiss would be reversed on appeal.

E. This Court's Ruling Contravenes Bankruptcy Policy

The court's order commits manifest error of law by contravening the overriding purpose of bankruptcy laws: to provide debtor with comprehensive, much needed relief from burden of his indebtedness by releasing him from virtually all his debts. This policy is furthered by the fact that 11 U.S.C. § 523(a) exceptions to discharge are narrowly construed against the creditor and in favor of debtor. *In re Harrell* (Bankr. W.D. Tex. 1988) 94 BR 86, 18 BCD 913; *In re Calvo* (Bankr. M.D. Fla. 1990) 111 BR 1003. Accordingly, the traditional application of § 523(a)(4) is quite narrow, as explained in the following:

"[§ 523(a)(4) is aimed only at the express trust situation in which the debtor either expressly

> signified his intention at the outset of the transaction, or was clearly put on notice by some document in existence at the outset, that he was undertaking the special responsibilities of a trustee to account for his actions over and above the normal obligations that contracting parties have to each other in a commercial transaction."

Spinoso v. Heilman (In re Heilman), 241 B.R. 137, 160 (Bankr. Md. 1999), citing *Bamco 18 v. Reeves (in re Reeves)*, 124 B.R. 5, 10 (Bankr. D. N.H. 1990).

CONCLUSION

Based on the foregoing, and in order to correct the manifest errors of law contained in the court's order denying Bonilla's motion to dismiss ATRs fourth claim for relief, Bonilla asks this court to reconsider and to reverse its order, thereby dismissing ATRs fourth claim for relief.

Dated: October 26, 2007

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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re HUGO N. BONILLA, Debtor.	No. 07-30309 Chapter 7 Case Adv. Proc. No. 07-03079 Date: December 14, 2007 Time: 9:30 a.m. Place: 235 Pine Street, Courtroom 23, San Francisco, California Judge: Hon. Thomas E. Carlson
ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, v. HUGO NERY BONILLA, Defendant.	

PLAINTIFFS' OPPOSITION TO THE DEFENDANT'S MOTION TO RECONSIDER ORDER DENYING DEFENDANT'S MOTION TO DISMISS PLAINTIFF'S FOURTH CLAIM FOR RELIEF

EXHIBIT H

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HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN

INTRODUCTION

On October 16, 2007, this Court issued an order ("12(b)(6) Ruling") denying the debtor Hugo Nery Bonilla's ("Bonilla" or "Defendant") Motion to Dismiss ("12(b)(6) Motion") the Fourth Claim for Relief in the Complaint of Plaintiffs ATR-Kim Eng Financial Corp. and ATR-Kim Eng Capital Partners, Inc. (collectively, "ATR" or "Plaintiffs"). In the 12(b)(6) ruling, the Court held that a debt is nondischargeable pursuant to the provisions of 11 U.S.C. section 523(a)(4)—which excepts from discharge debts that arise from "defalcation while acting in a fiduciary capacity"—if applicable state law imposes upon the debtor duties that are "*substantially similar* to the role of a trustee." 12(b)(6) Ruling at 4:20-24 (emphasis in original) (citing *In re Lewis*, 97 F.3d 1182 (9th Cir. 1996). The Court also held that Defendant is a "fiduciary" within the meaning of section 523(a)(4) because "the director of a corporation organized under Delaware law is subject to duties substantially similar to those imposed on the trustee of an express or technical trust." *Id.* at 5:12-17.[1]

Notwithstanding the fact that the parties submitted a combined 55 pages of briefing (which contained more than 200 separate citations to case and statutory authorities) and that Bonilla's counsel chose not to make any arguments at the hearing on the 12(b)(6) Motion on September 28, 2007, Bonilla now wants a "do over" to reargue the same positions he took in his original briefs. Styled as a motion for reconsideration ("Motion to Reconsider"), Bonilla cites only Rule 59(e) of the Federal Rules of Civil Procedure as a basis for challenging the Court's 12(b)(6) Ruling. Rule 59(e), however, cannot provide the relief that Bonilla seeks. By its own terms, Rule 59(e) is applicable only to judgments or appealable interlocutory orders. The 12(b)(6) Ruling is neither, and therefore cannot be reconsidered under Rule 59(e), and the Motion to Reconsider must be denied on that basis alone.

Even were the Court to entertain Bonilla's Motion to Reconsider, he offers no sufficient cause to reconsider the Court's 12(b)(6) Ruling and come to a different

[1] These holdings in the Court's 12(b)(6) Ruling provide the basis for ATR's motion for summary judgment on its Fourth Claim for Relief to determine that Bonilla's judgment debt of over $24.5 million owed to ATR is nondischargeable.

conclusion. Bonilla cannot satisfy any of the narrow bases for amending or altering an order under Rule 59(e)—*i.e.*, newly discovered evidence, an intervening change in controlling law or clear error by the Court. Instead, all the arguments Bonilla asserts are improper under Rule 59(e) because they were, or could have been, raised while the 12(b)(6) Motion was pending.

Bonilla's primary challenge to the Court's "substantially similar" analysis is based on *In re Cantrell*, 329 F.3d 1119 (9th Cir. 2003). However, this case was cited and fully discussed in Bonilla's prior briefs. This time around, Bonilla re-spins the case in a manner that not only fails to support his contentions but also contradicts his own earlier description of *In re Cantrell*'s holding. Furthermore, in quarreling with the Court's reliance on *In re Lewis*, 97 F.3d 1182 (9th Cir. 1996), Bonilla does not cite any new countervailing authority but merely offers his own self-serving (and inaccurate) interpretations of the case. Finally, to challenge the Court's holding that Delaware law imposes on corporate directors duties that are substantially similar to trustee duties, Bonilla asserts the same unpersuasive argument that he made in prior briefing, relying on the same two cases—*Bovay v. H.M. Byllesby & Co.*, 38 A.2d 808 (Del. 1944), and *Decker v. Mitchell (In re JTS Corp.)*, 305 B.R. 529 (Bankr. N.D. Cal. 2003).

As a district judge in this District Court stated recently, "it should not be supposed that [Rule 59(e)] is intended to give an unhappy litigant one additional chance to sway the judge." *Nolan v. Heald College*, No. C05-03399 MJJ, 2007 WL 878946, at *8 (N.D. Cal. Mar. 21, 2007). Bonilla's Motion to Reconsider does nothing more than seek a "second bite at the apple" and should be denied.

THE COURT'S 12(B)(6) RULING

Plaintiffs' Fourth Claim for Relief seeks to except from discharge a judgment debt of over $24.5 million that Bonilla owes to ATR. This judgment debt arises from a Delaware state court judgment holding that Bonilla, as a director of a Delaware corporation, breached his fiduciary duty to ATR, a minority shareholder of the corporation. ATR's Fourth Claim

for Relief alleges that this judgment debt arises from "defalcation while acting in a fiduciary capacity" and is nondischargeable under 11 U.S.C. section 523(a)(4).

In the 12(b)(6) Ruling, the Court stated "[w]hether a debtor is a fiduciary within the meaning of section 523(a)(4) is a question of federal law." 12(b)(6) Ruling at 2 (citing *In re Lewis*, 97 F.3d at 1185). Under federal law, according to the Court, "[t]he debtor must have been subject to the duties of a trustee before, and without reference to, the wrongdoing that gave rise to the debt, . . . the duties imposed on the debtor must be those imposed on the trustee of an express or technical trust [and] there must be an identifiable trust *res*, identifiable beneficiaries, and the debtor must be subject to the duties of loyalty, good faith, and honesty in caring for the trust *res*." *Id.* (citing *In re Lewis*, 97 F.3d at 1185-86 and n.1; *In re Arthur Shultz*, 208 B.R. 723, 728 (Bankr. M.D. Fla. 1997)).

A. The Court Engages In A "Substantially Similar" Analysis To Determine Whether A Debtor Is A Fiduciary Under Section 523(a)(4).

Focusing on the Ninth Circuit's statement that "the fiduciary relationship must be one arising from an express or technical trust" (*In re Lewis*, 97 F.3d at 1185), this Court undertook a closer examination whether "this mean[s] that in addition to preexisting the wrong, the fiduciary duty must be identical to that of a trustee in every technical respect[.]" *Id.* at 4. The Court reasoned that section 523(a)(4) does not require such a strictly technical application. The Court noted that *In re Lewis*, from which the "express or technical trust" language comes, held partners to be fiduciaries under section 523(a)(4) upon the basis of state-court decisions that imposed on partners the duties of loyalty, honesty, and fair dealing. *Id.* (citing *In re Lewis*, 97 F.3d at 1186). The Court further observed that "[o]ne of the decisions *In re Lewis* relied upon described the duties of a partner as merely 'similar to a trustee's,' and the other decisions cited failed to use the term trustee at all in describing the duties of a partner." *Id.* at 4-5 (citations omitted). Finally, the Court highlighted that the Ninth Circuit in *In re Lewis* noted with approval language in Collier stating that the duties of the fiduciary need only be "substantially similar" to those imposed on trustees. *Id.* (quoting *In re Lewis*, 97 F.3d at 1186 n.1). The Court therefore "conclude[d] that the fiduciary duty

[under section 523(a)(4)] must preexist the trust, and must be *substantially similar* to the role of a trustee, in that there must be a trust *res*, identifiable beneficiaries, and clear notice of the duties of loyalty, honesty, and fair dealing toward the beneficiaries in all matters affecting the trust *res*." *Id.* at 4 (emphasis in original).

B. The Court Determines That Delaware Law Imposes On Directors Duties That Are Substantially Similar To The Duties Of A Trustee.

In determining whether Bonilla was subject to duties sufficient to deem him to be a fiduciary under section 523(a)(4), the Court again relied on *In re Lewis* and held "[w]hether a debtor is subject to the duties just described is primarily a matter of state law," and these "requisite duties can be imposed by agreement, state statute, or state case law." *Id.* at 2-3 (citing *In re Lewis*, 97 F.3d at 1185-86). The Court thus looked to Delaware law to determine the types of duties that are imposed on directors of Delaware corporations.

The Court found that "[n]umerous Delaware decisions refer to directors as trustees, and impose on directors the highest duties of loyalty, honesty, and fair dealing in all matters concerning the management of corporate assets," and "impose this fiduciary duty prior to, and without reference to, any misconduct by the director." *Id.* at 3 (citing *Keenan v. Eshleman*, 2 A.2d 904, 908 (Del. 1938); *Hynson v. Drummond Coal Co., Inc.*, 601 A.2d 570 (Del. Ch. 1991); *Bodell v. Gen. Gas & Elec. Corp.*, 132 A. 442, 447 (Del. Ch. 1926)). The Court further noted, "Delaware case law clearly identifies the fiduciary duties of a corporate director, the trust *res* (all corporate assets), and the beneficiaries of the trust (the corporation and its shareholders)." *Id.*

The Court thus concluded that "the director of a corporation organized under Delaware law is subject to duties substantially similar to those imposed on the trustee of an express or technical trust, and those duties arise before and without reference to any wrongdoing," and the "[t]he director of a Delaware corporation is therefore a fiduciary within the meaning of section 523(a)(4)." *Id.* at 5 (citing *In re Zachary Shultz*, 205 B.R. 952, 959 (Bankr. D.N.M. 1997); *Foster v. Lasagna*, 609 F.2d 392, 396 (9th Cir. 1979) (director of corporation organized under California law is a fiduciary for purpose of section 523(a)(4)); and *Nahman*

v. Jacks (In re Jacks), 266 B.R. 728, 737 (9th Cir. B.A.P. 2001) (same)).

ARGUMENT

By his Motion to Reconsider, Bonilla faults the Court for not specifically addressing *In re Cantrell*, disagrees with the Court's "substantially similar" analysis based on *In re Lewis* (*id.* at 10-11), and urges the Court to take another look at two cases—*Bovay* and *In re JTS Corp.*—that he discussed and argued in a prior brief. Of course, Bonilla had ample opportunity to assert all these arguments while the 12(b)(6) Motion was pending. He did in fact raise these cases and some of these arguments in his prior briefs, and to the extent arguments were not articulated or the cases not framed the way Bonilla would now like, he could have refined his positions at the hearing on September 28, 2007, but his counsel chose not to do so. Regardless, Rule 59(e) is not an avenue for him now to reargue issues that were earlier briefed by the parties and considered and ruled upon by the Court.

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN

I. RULE 59(E) DOES NOT PERMIT RECONSIDERATION OF AN INTERLOCUTORY ORDER DENYING A MOTION TO DISMISS.

Bonilla gives short shrift to the procedural applicability of Rule 59(e) in seeking reconsideration of the Court's 12(b)(6) Ruling. The rule states in full, "[a] motion to alter or amend a judgment must be filed no later than 10 days after entry of the judgment." Fed. R. Civ. Proc. 59(e). Bonilla claims to have satisfied the 10-day filing deadline because he filed the Motion to Reconsider on October 26, 2007, and the Court issued the 12(b)(6) Ruling on October 16, 2007. Motion to Reconsider at 6:5-7. However, Bonilla completely misses the more important requirement of Rule 59(e)—that there be a "judgment"—which clearly is not present.

Although the term "reconsideration" does not appear in Rule 59(e), the rule has been interpreted to encompass a motion to reconsider certain court orders. *See* Wright, Miller & Kane, *Federal Practice and Procedure: Civil 2d* §2810.1 (1995). However, Rule 59(e) "clearly contemplates entry of judgment as a predicate to any motion." *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808, 812 (9th Cir. 1981), *overruled in part on other*

grounds. In re Washington Pub. Power Supply System Sec. Litig., 823 F.2d 1349, 1350-52, 1358 (9th Cir. 1987) (en banc). "[T]he requirement of a judgment as a prerequisite to moving for reconsideration under Rule 59(e) protects against the specter of piecemeal review." *Balla v. Idaho State Bd. of Corrections*, 869 F.2d 461, 467 (9th Cir. 1989) (citing *Stephenson*, 652 F.2d at 812). In *Stephenson*, the Ninth Circuit observed that "were we to permit Rule 59(e) motions without entry of judgment, litigants could obtain appellate review of partial judgments by simply appealing a Rule 59(e) order, completely bypassing the requirements of Rule 54(b) and 28 U.S.C. §1291." *Stephenson*, 652 F.2d at 812.

Bonilla's Motion to Reconsider fails to satisfy the "judgment" requirement of Rule 59(e). A "judgment" includes final judgments and appealable interlocutory orders. *See United States v. Martin*, 226 F.3d 1042, 1048 (9th Cir. 2000); *Balla*, 869 F.2d at 467 ("A judgment 'includes a decree and any order from which an appeal lies.'") (quoting Fed. R. Civ. P. 54(a)). The Court's 12(b)(6) Order, denying a motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, is neither a final judgment nor an appealable interlocutory order. *See American Fed'n of Gov't Employees Local 1 v. Stone*, 502 F.3d 1027, 1039-40 (9th Cir. 2007) (stating "general rule that defendants are not entitled to interlocutory appellate review of a district court's denial of a Rule 12(b)(6) motion"); *Figueroa v. United States*, 7 F.3d 1405, 1408 (9th Cir. 1993) ("Ordinarily, the denial of a 12(b)(6) motion is not a reviewable final order; it is only when a question of immunity is involved that we use the collateral order doctrine to exercise jurisdiction.").

Rule 59(e) therefore does not permit Bonilla to seek reconsideration of the Court's 12(b)(6) Ruling, and his Motion to Reconsider should be denied due to this fatal procedural shortcoming.

II. RULE 59 DOES NOT PERMIT A LOSING PARTY TO RESTATE OLD ARGUMENTS OR RAISE NEWLY-MINTED ARGUMENTS HE COULD HAVE ASSERTED DURING THE PENDENCY OF THE UNDERLYING MOTION.

A different result from that reached in the 12(b)(6) Ruling would not be warranted even if the Court were to entertain Bonilla's Motion to Reconsider. Rule 59(e) "offers an

'extraordinary remedy, to be used sparingly in the interests of finality and conservation of judicial resources.'" *Kona Enters., Inc. v. Estate of Bishop*, 229 F.3d 877, 890 (9th Cir. 2000) (citation omitted). "Under Rule 59(e), a Motion to Reconsider should not be granted, absent highly unusual circumstances, unless the district court is presented with newly discovered evidence, committed clear error, or if there is an intervening change in the controlling law." *389 Orange Street Partners v. Arnold*, 179 F.3d 656, 665 (9th Cir. 1999); *see also Hawaii Stevedores, Inc. v. HT & T Co.*, 363 F. Supp. 2d 1253, 1269 (D. Haw. 2005) ("[A] motion for reconsideration must set forth facts or law of a strongly convincing nature to induce the court to reverse its prior decision.").

"Mere disagreement with a previous order is an insufficient basis for reconsideration." *Hawaii Stevedores*, 363 F. Supp. 2d at 1269. "A party seeking reconsideration must show more than a disagreement with the Court's decision, and recapitulation of the cases and arguments considered by the court before rendering its original decision fails to carry the moving party's burden." *United States v. Westlands Water Dist.*, 134 F. Supp. 2d 1111, 1131 (E.D. Cal. 2001); *see also McAnaney v. Astoria Fin. Corp.*, 233 F.R.D. 285, 287 (E.D.N.Y. 2005) ("A Motion to Reconsider cannot be granted . . . solely on a party's disagreement with the Court's ruling.") (citation omitted); *Nolan*, 2007 WL 878946 at *8 ("Whatever may be the purpose of Rule 59(e) it should not be supposed that it is intended to give an unhappy litigant one additional chance to sway the judge"). Furthermore, "[a] Rule 59(e) motion may *not* be used to raise arguments or present evidence for the first time when they could reasonably have been raised earlier in the litigation." *Kona Enters.*, 229 F.3d at 890 (emphasis in original). "Rule 59(e) 'does not provide a vehicle for a party to undo its own procedural failures [or] allow a party to introduce new evidence or advance new arguments that could and should have been presented to the district court prior to the judgment.'" *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Garber*, No. 94-5414 AWI DLB, 2007 WL 3407257, at *2 (E.D. Cal. Nov. 14, 2007) (quoting *Dimarco-Zappa v. Cabanillas*, 238 F.3d 25, 34 (1st Cir. 2001)).

Under these standards, Bonilla's Motion to Reconsider is not well taken. Rather than

assert newly discovered evidence, cite an intervening change in controlling law or demonstrate that the Court committed clear error, Bonilla's Motion to Reconsider offers only restatements of his prior arguments or newly-minted (and unpersuasive) arguments on issues already decided that Bonilla could have raised while the 12(b)(6) Motion was pending.

A. Bonilla's Challenge To The Court's Adoption Of The "Substantially Similar" Standard Does Not Warrant Reconsideration.

Bonilla's primary contention in the Motion to Reconsider is that the Court erred by conducting a "substantially similar" analysis to determine whether the fiduciary requirement of section 523(a)(4) is met. *See* 12(b)(6) Ruling at 4-5. Bonilla asserts three challenges the Court's analysis: (1) the Court "overlook[ed] and fail[ed] to distinguish" *In re Cantrell*, *supra*; (2) the Court misapplied *In re Lewis*, *supra*, because the case "did not state that it was adopting a 'substantially similar' test"; and (3) the Court's ruling "contravene[es] the overriding purpose of bankruptcy laws." *See* Motion to Reconsider at 8-11.

1. The "Substantially Similar" Analysis Was The Key Issue In Dispute And Was Extensively Briefed By The Parties.

The central issue in dispute on Bonilla's 12(b)(6) Motion was whether, under governing law, directors of a Delaware corporation are "acting in a fiduciary capacity" within the meaning of section 523(a)(4). In his memorandum of points and authorities supporting the 12(b)(6) Motion ("Bonilla's MPA"), Bonilla argued that the fiduciary relationship contemplated under section 523(a)(4) can only arise from a statutory or express trust and cannot be based on a trust *ex maleficio*. Bonilla's MPA at 8-9. Acknowledging the applicability of state law, Bonilla conceded, "[b]ecause Delaware was the state of incorporation of the Delaware Holding Co. (Compl. at ¶12), Delaware state law determines whether there was an express or statutory trust which imposed trust duties on Bonilla, as meant by Section 523(a)(4)." *Id.* at 9:23-25. Purporting to cite Delaware law accurately, Bonilla claimed that Delaware imposes on directors trust duties only under the Delaware trust fund doctrine, when the corporation is insolvent or when the director has committed

misfeasance,. *Id.* at 9-12. Because such a trust arises *ex maleficio*, Bonilla claimed, "[i]t is clear that Delaware law does not impose an express or statutory trust on corporate directors." *Id.* at 9:25-26.

By contrast, in its opposition to Bonilla's 12(b)(6) Motion ("ATR's Opposition"), ATR argued that the term "fiduciary" under section 523(a)(4) is not limited to cases in which there is a written trust agreement or a statute that specifically uses the term "trust" or "trustee." Citing cases in the Ninth Circuit and throughout the country, ATR contended that the fiduciary requirement of section 523(a)(4) can be satisfied in "circumstances in which 'trust-type' obligations are imposed on a debtor pursuant to state common-law," that is, in the Court's words, when state law imposes duties that are substantially similar to the duties of a trustee. ATR's Opposition at 11-12.[2] As a primary example of this principle, ATR emphasized *In re Lewis*, the same case the Court relied upon to engage in the "substantially similar" analysis. *See id.* at 12. ATR noted that although *In re Lewis* involved partners, the Ninth Circuit examined applicable Arizona law and observed "[t]he relation of partnership *is fiduciary in character*." *In re Lewis*, 97 F.3d at 1186 (quoting *DeSantis v. Dixon*, 236 P.2d

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[2]Specifically, ATR cited *In re Teichman*, 774 F.2d 1395, 1399 (9th Cir. 1985) ("state law takes on importance in determining when a trust exists. The state may impose trust-like obligations on those entering into certain kinds of contracts, and these obligations may make a contracting party a trustee") (internal quotation marks omitted); *In re Stanifer*, 236 B.R. 709, 714 (9th Cir. BAP 1999) ("The 'technical' or 'express' trust requirement includes relationships in which trust-type obligations are imposed pursuant to statute or common law"); *In re Colton*, No. 05-56430-MM, 2007 WL 1615069, at *3 (Bankr. N.D. Cal. June 4, 2007) ("in some instances, a state statute or common law doctrine may impose trust-like obligations that are sufficient to satisfy the requirements of an express trust"); *cf. Lewis v. Short (In re Short)*, 818 F.2d 693, 695-96 (9th Cir. 1987) (holding that Washington common law imposed trustee-like duties on partners of partnership); *see also In re Bennett*, 989 F.2d 779, 784-85 (5th Cir. 1993) ("most courts today . . . recognize that the 'technical' or 'express' trust requirement is not limited to trusts that arise by virtue of a formal trust agreement, but includes relationships in which trust-type obligations are imposed pursuant to statute or common law"); *In re Moskowitz*, 310 B.R. 21, 30 (Bankr. E.D.N.Y. 2004) ("Technical or express trusts include relationships where trust-type obligations are imposed pursuant to statute or common law"); *In re Cook*, 263 B.R. 249, 255 (Bankr. N.D. Iowa 2001) ("[t]he 'technical' or 'express' trust requirement is not limited to trusts that arise by virtue of a formal trust agreement, but includes relationships in which trust-type obligations are imposed pursuant to statute or common law"); *In re Sullivan*, 217 B.R. 670, 675 (Bankr. D. Mass. 1998) ("A technical trust is a trust that is imposed by law and may arise either by statute or common law").

38, 41 (Ariz. 1951)) (emphasis added). Specifically, as the Ninth Circuit noted, Arizona law imposes on partners "the obligation of the utmost good faith in their dealings with one another with respect to partnership affairs, of acting for the common benefit of all the partners in all transactions relating to the firm business, and of refraining from taking any advantage of one another by the slightest misrepresentation, concealment, threat or adverse pressure of any kind." *Id.*

Bonilla shifted his position in the reply to ATR's Opposition ("Bonilla's Reply"). In his MPA, Bonilla had originally acknowledged that Delaware law determines whether a director of a Delaware corporation is subject to the types of duties that would make him a "fiduciary" under section 523(a)(4). *See* Bonilla's MPA at 9:23-25. However, in his Reply, Bonilla relied on *In re Heilman*, 241 B.R. 137 (Bankr. D. Md. 1999), to argue that Delaware state law is not necessarily relevant to this determination. *See* Bonilla's Reply at 6:3-6. Under *In re Heilman*, according to Bonilla, section 523(a)(4) "requires that the relationship itself be one that entails an express trust, foreclosing the possibility that an express trust may be created as a creature of pure common law." *Id.* at 7:8-9. Acknowledging that the "substantially similar" analysis advocated by ATR (and employed by this Court) "has been followed by some courts," Bonilla nevertheless contended that "[t]he correct approach" under *In re Heilman* "is to first analyze whether the relationship in itself is one that would qualify as an express trust under Section 523(a)(4), and then to look to see whether such a relationship exists under state law." *Id.* at 6:21-24. Based on his reliance on *In re Heilman*, Bonilla thus argued that "[c]learly, the director-shareholder relationship is not one of express trust." *Id.* at 9:4-5.

Nowhere in his Reply did Bonilla attempt to address the critical holding from *In re Lewis*, which ATR and this Court relied upon, establishing that in the Ninth Circuit applicable state law determines whether a debtor is subject to the types of duties that would make him a fiduciary under section 523(a)(4). *See In re Lewis*, 97 F.3d at 1185. Bonilla also never claimed that *In re Lewis* did not engage in a "substantially similar" analysis, as ATR contended and as this Court ultimately determined. Bonilla instead only sought to

distinguish *In re Lewis* on its facts, emphasizing that it involved partners, not corporate directors. *See id.* at 9-11 and 12-13.

The Court held a hearing on Bonilla's 12(b)(6) Motion on September 28, 2007. Counsel for both sides appeared. ATR's counsel presented extensive oral argument that the Court should follow the "substantially similar" analysis found in *In re Lewis* and that Delaware law did indeed impose duties on corporate directors that are substantially similar to the duties of a trustee. *See* Motion to Reconsider at 4:14-15 (recalling that ATR's counsel "urged the court to adopt the reasoning of bankruptcy court decisions which apply the 'substantially similar' test" at the September 28 hearing). The Court gave Bonilla's counsel the opportunity to respond, but he declined. Bonilla's counsel made no arguments at the September 28 hearing.

2. Bonilla's Current Arguments Against The Court's "Substantially Similar" Analysis Were Already, Or Could Have Been, Raised Earlier.

All three arguments that Bonilla seeks now to assert in the Motion to Reconsider against the Court's "substantially similar" analysis were, or could have been, raised in his prior briefs or at the September 28 hearing, and all were explicitly or implicitly rejected by this Court. In his chief argument, Bonilla abandons *In re Heilman* (making no mention of it) and instead relies on *In re Cantrell*, which he contends is "more relevant and current" than *In re Lewis* and "did not apply a 'substantially similar' test to determine whether the defendant was a fiduciary under §523(a)(4)." Motion to Reconsider at 8:12-17. Bonilla never cited *In re Cantrell* in his prior briefs in this manner. To the contrary, on page 11 of his Reply, Bonilla apparently conceded the exact opposite, stating "the court in *In re Cantrell* . . . applied the 'trust-type duties' approach that ATR advocates." Bonilla's Reply at 11:1-2. It is not surprising then that, in his prior briefs, Bonilla had not relied on *In re Cantrell* to argue against the "substantially similar" analysis. Bonilla instead cited this case in his MPA only as support for his collateral estoppel argument, a completely innocuous proposition in the context of the 12(b)(6) Motion. *See* Bonilla's MPA at 7 (citing *In re Cantrell* for the proposition that "collateral estoppel principles do indeed apply in discharge

proceedings pursuant to §523(a)" and that "28 U.S.C. §1738 requires [courts], as a matter of full faith and credit, to apply the pertinent state's collateral estoppel principles"). And in his Reply, Bonilla only tried to analogize *In re Cantrell*'s facts to this case noting that "[a]lthough the court in *In re Cantrell* cited *Ragsdale* and applied the 'trust-type duties' approach that ATR advocates, the court found that the nature of the relationship of corporate principal to director was too dissimilar to an express trust to justify a denial of discharge under 523(a)(4)." Bonilla's Reply at 11 and n.10.

This same argument by purported analogy from Bonilla's Reply is restated in the Motion to Reconsider. Bonilla again argues that "*Cantrell* determined that California corporate directors are not fiduciaries under §523(a)(4) because California law . . . holds that corporate directors are not trustees." Motion to Reconsider at 8:17-9:2. As he did in his Reply, Bonilla places too much weight on *In re Cantrell* and unjustifiably extends it beyond its holding. Far from disapproving or overruling the "substantially similar" analysis employed by *In re Lewis*, *In re Cantrell* cited and relied on the critical holding from *In re Lewis* that "[w]hile the definition of 'fiduciary' is governed by federal law, we have relied in part on state law to ascertain whether the requisite trust relationship exists." *In re Cantrell*, 329 F.3d at 1125 (citing *In re Lewis*, 97 F.3d at 1185). Accordingly, the Ninth Circuit in *In re Cantrell* focused exclusively on California law and the types of duties that are imposed on directors of California corporations. *Id.* at 1126-27. Resting its decision on a California Supreme Court case, the Ninth Circuit held that a California corporate director is not a fiduciary within the meaning of section 523(a)(4). *Id.* at 1128. By its own terms, *In re Cantrell* has no application to this case because Bonilla was a director of a Delaware corporation. Delaware law, not California law, determines whether Bonilla was subject to the types of duties sufficient to satisfy the "fiduciary" requirement of section 523(a)(4).[3]

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[3]Bonilla ignores the one published case that is most directly on point, *In re Zachary Shultz*, 205 B.R. at 952. *In re Zachary Shultz* thoroughly examined Delaware law, found that Delaware law imposed duties on a director of a Delaware corporation that are substantially similar to the duties of a trust and concluded that a Delaware corporate director is a fiduciary within the meaning of section 523(a)(4). *See id.* at 958-60. ATR discussed *In re* (continued . . .)

The Court did not overlook *In re Cantrell*, and Bonilla's rehashed reliance on the case is not a proper basis for reconsideration. As one court has stated, "the re-arguing of the applicability of [a case] in the guise of bringing 'overlooked' authority to the Court's attention borders on the contumacious, as the question was extensively briefed by both parties in the original submissions." *JPMorgan Chase Bank v. Cook*, 322 F. Supp. 2d 353, 356 (S.D.N.Y. 2004).

The same can be said of Bonilla's remaining two arguments against the Court's "substantially similar" analysis—that the Ninth Circuit in *In re Lewis* did not explicitly adopt a "substantially similar" test, and that the Court's 12(b)(6) Ruling contravenes the purpose of bankruptcy law to narrowly construe section 523(a)(4) in order "to provide debtor with comprehensive, much needed relief from burden of his indebtedness by releasing him from virtually all his debts." *See* Motion to Reconsider at 10-11. Contrary to Bonilla's claim that the Court engaged in the "substantially similar" analysis "without explanation" (*id.* at 10:7-8), this Court clearly articulated why *In re Lewis* supports such analysis. *See* 12(b)(6) Ruling at 4-5. Bonilla does not cite much less question the correctness of the Court's reasoning and does not address the numerous other cases (including cases in the Ninth Circuit) cited by ATR demonstrating that courts apply the "substantially similar" analysis in the context of section 523(a)(4). *See* footnote 1, *supra.* Furthermore, Bonilla's reference to bankruptcy policy is superficial and unpersuasive. Although bankruptcy law generally is intended to relieve debtors by discharging debts, it also clearly recognizes 19 exceptions of nondischargeable debts. This Court applied sound reasoning, based on applicable precedents and governing law, that Bonilla's judgment debt to ATR falls squarely within the exception to discharge found at section 523(a)(4), debts as a result of deprecation by a fiduciary. Bonilla may be displeased with the result, but the Court's 12(b)(6) Ruling did not thwart bankruptcy policy or misapply section 523(a)(4).

(. . . continued)
Shultz at length (*see* ATR's Opposition at 20-22) and this Court cited it in holding the director of a Delaware corporation is a fiduciary within the meaning of section 523(a)(4). *See* 12(b)(6) Ruling at 5:15-18.

Notwithstanding the unpersuasiveness of these arguments, Bonilla could have raised them earlier. It was clear that ATR relied heavily on *In re Lewis* specifically as precedent for the "substantially similar" analysis. Bonilla just as clearly could have asserted the arguments he hopes to make now in his Reply or at the September 28 hearing, but he chose not to do so. Like his renewed reliance on *In re Cantrell*, Bonilla cannot quarrel with the Court's "substantially similar" analysis based on arguments he could have raised earlier. *See Kona Enters.*, 229 F.3d at 890 ("A Rule 59(e) motion may *not* be used to raise arguments or present evidence for the first time when they could reasonably have been raised earlier in the litigation.") (emphasis in original); *Parrish v. Sollecito*, 253 F. Supp. 2d 713, 715 (S.D.N.Y. 2003) ("A Rule 59(e) motion, however, is not intended as a vehicle for a party dissatisfied with the Court's ruling to advance new theories that the movant failed to advance in connection with the underlying motion, nor to secure a rehearing on the merits with regard to issues already decided."); *O'Toole By and Through O'Toole v. Olathe Dist. Schools Unified School Dist. No. 223*, 963 F. Supp. 1000, 1016 (D. Kan. 1997) ("[T]he court will not permit the plaintiff to raise new arguments or attempt to bolster her previously unsuccessful arguments in a motion to reconsider.").

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B. Bonilla's Contention That Delaware Law Only Imposes Trusts *Ex Maleficio* Does Not Warrant Reconsideration.

Bonilla also seeks to challenge the Court's holding that Delaware law imposes duties on corporate directors that are substantially similar to the duties of a trustee. *See* 12(b)(6) Ruling at 2:23-3:17 and 5:12-22. Relying on *Bovay.*, 38 A.2d at 808, and *In re JTS Corp.*, 305 B.R. at 529, Bonilla claims in the Motion to Reconsider that "Delaware imposes heightened fiduciary and trustee duties on directors in limited circumstances and pursuant to a constructive trust or *ex maleficio*, neither of which are included within the purview of §523(a)(4)." *See* Motion to Reconsider at 6-8. This argument is a blatant attempt to rehash an old argument (relying on the same cases) that Bonilla made in his MPA.

1. Bonilla Relied On *Bovay* And *In re JTS Corp.* In His MPA To Argue That Delaware Only Imposes Trusts On Corporate Directors *Ex Maleficio*.

Following the contention that the "substantially similar" analysis was appropriate in its Opposition, ATR demonstrated that Delaware law did indeed impose on corporate directors duties that are substantially similar to those of a trustee. *See* ATR's Opposition at 12-17. According to ATR, "Delaware law has historically imposed 'trust-type' duties on its directors that are at least as demanding as those recognized in *In re Lewis*." *Id.* at 12-13. In particular, ATR noted that the Delaware courts have "demand[ed] of a corporate . . . director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers." *Id.* at 13 (quoting *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. Ch. 1939)). Furthermore, ATR argued that those "unyielding fiduciary duties" include the duty of care and loyalty, and the subsidiary duty of good faith. *Id.* (quoting *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006)). These duties, ATR contended, "grow from the experience of Delaware courts interpreting the law of trusts." *Id.* at 14.[4]

[4]ATR cited *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 168 (Del. 2002) ("efforts by a fiduciary to escape a fiduciary duty, whether by a corporate director or officer *or other type of trustee*, should be scrutinized searchingly") (emphasis added); *Hynson*, 601 A.2d at 575 ("[T]he fiduciary duty of corporate directors is a court created duty that historically springs from equity's experience with trusts and trustees"); *Petty v. Penntech Papers, Inc.*, 347 A.2d 140, 143 (Del. Ch. 1975) ("Clearly directors of a corporation *stand in a position of trustees* with the stockholders, [citations] and the utmost good faith and fair dealing are required of them, especially where their individual interests are concerned"); *Prestancia Mgmt. Group, Inc. v. Virginia Heritage Found., II LLC*, No. Civ. A. 1032-S, 2005 WL 1364616, at *6 (Del. Ch. May 27, 2005) ("[a] fiduciary relationship is a situation where one person reposes special trust in and reliance on the judgment of another or where a special duty exists on the part of one person to protect the interests of another. The relationship connotes a dependence. The traditional relationships recognized by equity as 'special' are express trustees and corporate officers and directors"); *Grace v. Morgan*, No. Civ. A 03C05260JEB, 2004 WL 26858, at *2 (Del. Super. Jan. 6, 2004) (holding that the "classic examples" of "a special relationship of trust [that] exist[s] between the parties sufficient to establish the fiduciary duty" include "the trustee responsible for the trust *res* for the beneficiary and the corporate officer or director responsible to (continued . . .)

Bonilla never directly challenged ATR's discussion of Delaware law and the trust-type duties that are imposed on Delaware corporate directors. Bonilla's Reply failed to address the particular Delaware cases cited by ATR, and the only discussion of Delaware law that appears in Bonilla's prior briefs is found in his MPA. In his MPA, Bonilla argued that Delaware law does not impose express or statutory trusts on corporate directors but only imposes trusts *ex maleficio* pursuant to the Delaware trust fund doctrine. Bonilla's MPA at 9-10. Bonilla propounded two cases in support of this contention. According to Bonilla, the first case, *In re Arthur Shultz*, 208 B.R. at 729, did not find that Delaware law imposes express or statutory trusts on corporate officers and that an individual's "position as a director does not per se make him a trustee to the corporation." *See id.* at 10-11. *In re Arthur Shultz* held, nevertheless, that a Delaware corporate director is a fiduciary within the meaning of section 523(a)(4) (*In re Arthur Shultz*, 208 B.R. at 729), but Bonilla downplayed that holding. Bonilla also discussed *In re JTS Corp.*, which he claimed presented an analysis of the Delaware trust fund doctrine as stated in *Bovay*, and found that "directors are not trustees in a strict and technical sense but may be treated as such when they have 'unlawfully profited through breach of duty, and at the expense of the corporation.'" Bonilla's MPA at 12.

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2. Bonilla Again Relies On *Bovay* And *In re JTS Corp.* To Make The Same Unpersuasive Arguments Asserted In His MPA.

Bonilla offers nothing new from *Bovay* and *In re JTS Corp.* On the contrary, he makes the same argument regarding *Bovay* and *In re JTS Corp.* that he made in his MPA. *Compare* Bonilla's MPA at 12:10-13 *with* Motion to Reconsider at 6:22-24; Bonilla's MPA at 12:4-24 *with* Motion to Reconsider at 7:6-19. In restating his arguments, Bonilla ignores the Court's citations to other Delaware decisions and does not account for the Court's own consideration

(. . . continued)
shareholders"); and *In re Shoe-Town, Inc. Stockholders Litig.*, No. C.A. No. 9483, 1990 WL 13475, at *7 (Del. Ch. Feb. 12, 1990) (characterizing directors as "quasi trustees. . . . a director will be held as a trustee for the corporation he has undertaken to represent") (citations omitted).

of *Bovay* in reaching its conclusions. *See* 12(b)(6) Ruling at 3-4. Nor does Bonilla address the numerous Delaware cases cited by ATR showing that Delaware does impose on directors duties substantially similar to trustee duties. Bonilla wishes simply to reargue *Bovay* and *In re JTS Corp.* in a vacuum in hopes that the Court will change its mind on an issue that has already been decided against him. Rule 59(e) does not permit reconsideration for such a purpose. *See Westlands*, 134 F. Supp. 2d at 1131 ("recapitulation of the cases and arguments considered by the court before rendering its original decision fails to carry the moving party's burden [on a motion for reconsideration]."); *Horizon Lines, LLC v. United States*, 429 F. Supp. 2d 92, 96-97 (D.D.C. 2006) (denying motion to reconsider where the movant's "arguments are basically a rehash of the arguments [it] presented at the summary judgment stage . . . . [and] merely disagrees with how the Court weighed the facts and interpreted the case law.").

CONCLUSION

For the foregoing reasons, ATR urges that the Court deny Defendant's Motion to Reconsider.[5]

DATED: November 30, 2007.

Respectfully,

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN
A Professional Corporation

By: /s/
WILLIAM J. LAFFERTY

Attorneys for Plaintiffs ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC.

[5] In the interest of economy, ATR has not individually addressed each argument contained in Bonilla's Motion to Reconsider, although all of them are unpersuasive. At the hearing on the Motion to Reconsider, ATR will be prepared to address any additional issues that arise.

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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re HUGO N. BONILLA, Debtor.	No. 07-30309 Chapter 7 Case Adv. Proc. No. 07-03079 Date: December 14, 2007 Time: 9:30 a.m. Place: 235 Pine Street, Courtroom 23, San Francisco, California Judge: Hon. Thomas E. Carlson
ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, v. HUGO NERY BONILLA, Defendant.	

PLAINTIFFS' NOTICE OF MOTION AND MOTION FOR SUMMARY JUDGMENT ON THE FOURTH CLAIM FOR RELIEF; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

[REQUEST FOR JUDICIAL NOTICE and DECLARATION OF LONG X. DO SUBMITTED CONCURRENTLY]

EXHIBIT I

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN

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NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE that on December 14, 2007, at 9:30 a.m., in Courtroom 23 of the Honorable Thomas E. Carlson, United States Bankruptcy Judge, located at 235 Pine Street, San Francisco, California, Plaintiffs ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. (collectively "Plaintiffs" or "ATR"), will and hereby do move for summary judgment against Defendant Hugo Nery Bonilla, the debtor in the above-captioned Chapter 7 case ("Debtor," "Defendant" or "Bonilla"), with respect to the Fourth Claim for Relief set forth in Plaintiff's Complaint, to declare a $24,490,422.50 judgment debt, plus post-judgment interest of $490,647.16, of the Debtor nondischargeable pursuant to 11 U.S.C. §523(a)(4). The Motion is brought pursuant to Federal Rules of Civil Procedure, Rule 56, applicable herein pursuant to Federal Rules of Bankruptcy Procedure, Rule 7056.

The Motion is based on this Notice of Motion and Motion, the accompanying Memorandum of Points and Authorities, the Request for Judicial Notice (the "RJN") and the Declaration of Long X. Do submitted concurrently herewith, the record in this case to the extent properly considered in connection with this Motion, the arguments of counsel at the hearing on the Motion, and any other matters properly brought before the Court.

PLEASE TAKE FURTHER NOTICE that Bankruptcy Local Rules ("BLR") 7007-1 and 9013 prescribe the procedures to be followed and that:

(1) any opposition to the Motion must be filed with the Court and served by first class mail on appropriate parties (including counsel for Plaintiffs at the address set forth above) at least fourteen (14) days prior to the scheduled hearing on the Motion (BLR 7007-1(b) and 9013-3);

(2) unless the Court expressly orders otherwise, response papers shall not exceed twenty five (25) pages of text and, if exceeding ten (10) pages of text, shall also include a table of contents and a table of authorities (BLR 9013-1(c)); and

(3) unless required by the assigned Judge, no separate statement of undisputed facts or joint statement of undisputed facts shall be submitted (Civil Local Rule 56-2, made

applicable by BLR 1001-2).

MEMORANDUM OF POINTS AND AUTHORITIES

INTRODUCTION

The relief sought in this Motion by Plaintiffs ATR-Kim Eng Financial Corporation and ATR-Kim Eng Capital Partners, Inc. (collectively, "ATR" or "Plaintiffs") flows naturally from the Court's holdings in its "Memorandum re Defendant's Rule 12(b)(6) Motion," filed on October 16, 2007 (the "12(b)(6) Ruling"), that Hugo Nery Bonilla, the debtor in the above-captioned Chapter 7 case ("Debtor," "Defendant" or "Bonilla"), committed defalcation while acting in a fiduciary capacity. In the 12(b)(6) Ruling, the Court denied the Debtor's motion to dismiss the Fourth Claim for Relief in ATR's Complaint, which asserts that a judgment debt Bonilla owes to ATR is nondischargeable under Chapter 5 of the United States Bankruptcy Code, because it arises from "defalcation while acting in a fiduciary capacity." 11 U.S.C. §523(a)(4).

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Bonilla's judgment debt arises from his role as a director of a Delaware corporation called PMHI Holdings Corp. (the "Delaware Holding Company") in which ATR was a 10 percent minority shareholder. In the Delaware Chancery Court, ATR sued Bonilla and the two other directors of the Delaware Holding Company—Carlos R. Araneta ("Araneta") and Liza Berenguer ("Berenguer")—for breaches of fiduciary duty arising from Araneta's wrongful liquidation of the Delaware Holding Company's most valuable assets to the detriment of Plaintiffs. After a trial, the Delaware Chancery Court found that Araneta's actions amounted to self-dealing and a breach of his duty of loyalty to ATR, as a minority shareholder of the Delaware Holding Company. Bonilla and Berenguer, according to the Delaware Chancery Court, also breached their fiduciary duty to ATR by failing to monitor Araneta's misconduct, protect ATR's interests, or stop Araneta from liquidating the Delaware Holding Company's assets without informing or compensating Plaintiffs. The Delaware Chancery Court concluded that Bonilla, Araneta and Berenguer were jointly and severally liable to ATR for damages in the amount of approximately $24.5 million, plus post-judgment interest.

In the 12(b)(6) Ruling this Court held as a matter of law that the findings of the Delaware Chancery Court amounted to defalcation by Bonilla as a fiduciary within the meaning of section 523(a)(4). In so holding, the Court treated the Delaware Chancery Court's findings as allegations accepted to be true, as the Court must for purposes of a Rule 12(b)(6) motion. By this Motion, ATR requests that the Court accept these findings as true and indisputable under the doctrine of collateral estoppel and the provisions of 28 U.S.C. §1738, which require that a federal court give "full faith and credit" (28 U.S.C. §1738) to state court judgments. The Delaware Chancery Court's findings that Bonilla breached his fiduciary duty to ATR cannot be relitigated in this adversary proceeding because the issue was fully litigated in Delaware, forms the basis of ATR's Fourth Claim for Relief, was essential to the Delaware Chancery Court's judgment and was made final when the Delaware Supreme Court affirmed the judgment of the Delaware Chancery Court. The Court accordingly should grant ATR's Motion and enter summary judgment on the Fourth Claim for Relief in ATR's favor, finding Bonilla's judgment debt to ATR to be nondischargeable under section 523(a)(4).

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FACTUAL BACKGROUND

A. PROCEDURAL HISTORY.

1. The Delaware Action.

On June 3, 2004, ATR commenced an action in the Delaware Chancery Court against Bonilla, Araneta and Berenguer—the directors of the Delaware Holding Company—entitled *ATR-Kim Eng Financial Corp., et al. v. Carlos R. Araneta, Hugo Bonilla, et al.*, C.A. No. 489-N (Del. Ch. 2006) ("Delaware action"). RJN Ex. 1 at *7. ATR asserted claims for damages against the directors of the Delaware Holding Company for breaches of their fiduciary duty to ATR, which was a 10 percent minority shareholder in the company.

After a trial of the Delaware action, on December 11, 2006, the Delaware Chancery Court issued a 54-page Memorandum Opinion articulating its findings of facts and conclusions of law. *See* RJN Ex. 1. As further detailed below, the Delaware Chancery Court found that Araneta "breached his duty of loyalty by impoverishing the Delaware Holding

Company for his own personal enrichment." *Id.* at *1. Bonilla and Berenguer were found also to have breached their fiduciary duties to ATR because of their complicity in Araneta's misfeasance: "Having assumed the important fiduciary duties that come with a directorship in a Delaware corporation, Bonilla and Berenguer acted as—no other word captures it so accurately—stooges for Araneta, seeking to please him and only him, and having no regard for their obligations to act loyally towards the corporation and all of its stockholders." *Id.* The Order of Final Judgment in the Delaware action ("Final Judgment") was entered on January 10, 2007. RJN Ex. 2. In the Final Judgment, the Delaware Chancery Court held Bonilla, Araneta and Berenguer jointly and severally liable for damages to ATR in the amount of $24,490,422.50, plus post-judgment interest accruing at a rate of 11.25 percent per annum. RJN Ex. 2 at 1. The Final Judgment is now final for all purposes.[1]

2. The Instant Bankruptcy Proceedings.

On January 29, 2007, ATR entered the Final Judgment of the Delaware Chancery Court in California in Alameda County Superior Court, as a sister-state judgment. *See* RJN Ex. 4. On March 16, 2007, Bonilla filed a voluntary petition (the "Petition") in this Court under Chapter 7 of the United States Bankruptcy Code. The amount of post-judgment interest accruing from the date of the Delaware Chancery Court's Final Judgment to the date Bonilla filed his Petition is $490,647.16. Declaration of Long X. Do ¶2.

ATR timely filed the instant adversary Complaint on July 23, 2007 (Docket No. 1). ATR seeks a declaration that Defendant is not entitled to a discharge because he: (1) engaged in fraudulent transfers of real property within one year of the filing of the bankruptcy petition pursuant to Section 727(a)(2)(A) (*see* Compl. ¶¶63-65 (First Claim for Relief)); (2) failed to maintain books, documents, records and papers from which his financial condition or business transactions might be ascertained pursuant to Section

[1]The Delaware Supreme Court affirmed the Final Judgment in a two-page summary decision entered on June 14, 2007. *See* RJN Ex. 3. Specifically, the Delaware Supreme Court held that "the final judgment of the Court of Chancery should be affirmed on the basis of and for the reasons assigned by the Court of Chancery in its [Memorandum Opinion] decision dated December 21, 2006." *Id.* at 1-2.

727(a)(3) (*see* ¶¶66-68 (Second Claim for Relief)); and (3) failed to explain satisfactorily the loss or deficiency of assets pursuant to Section 727(a)(5) (*see* Compl. ¶¶69-71 (Third Claim for Relief)). Additionally, in the Fourth Claim for Relief, the subject of this Motion, ATR seeks a determination that Defendant's judgment debt arising from the Delaware action is nondischargeable because it arises from "fraud or defalcation while acting in a fiduciary capacity," under section 523(a)(4). Compl. ¶76. In its Complaint, ATR alleges:

> 73. In his capacity as Director of a Delaware corporation, Bonilla owed fiduciary duties to ATR, the Delaware Holding Company's minority shareholder, that predated the debt in this case. Those pre-existing fiduciary duties imposed upon Bonilla the responsibility for safeguarding the value of the assets of the Delaware Holding Company and, thereby, preserving the value of ATR's interest as a minority shareholder in the Delaware Holding Company.
>
> 74. Further, as a director of a Delaware corporation, Bonilla stood in the position of a trustee for the shareholders of the Delaware Holding Company, including ATR. That trust relationship predated the debt owed by Bonilla to ATR and existed without reference to that debt.
>
> 75. Bonilla's failure—as found by the Delaware Chancery Court—to monitor Araneta's actions, to prevent him from removing assets from the Delaware Holding Company to his family members without consideration, or to take any steps to protect ATR's interest as a minority shareholder, facilitated and enabled Araneta's wrongful transfer of assets from the Delaware Holding Company, resulting in the misappropriation of funds held in a fiduciary capacity. Further, by failing to respond to ATR's discovery requests in the Delaware action, Bonilla failed properly to account for the investment ATR made in the Delaware Holding Company.
>
> 76. As a result of these actions, Bonilla's Judgment Debt to ATR arises from "fraud or defalcation while acting in a fiduciary capacity," within the meaning of 11 U.S.C. Section 523(a)(4) and therefore should be excepted from discharge. (Compl. ¶¶73-76)

On August 31, 2007, Bonilla filed a motion to dismiss ATR's Fourth Claim for Relief pursuant to Rule 12(b)(6). *See* Docket No. 8. After briefing and a hearing on September 28, 2007, the Court issued its 12(b)(6) Ruling and accompanying Order Denying Bonilla's 12(b)(6) Motion. *See* Docket Nos. 15 & 16, respectively. The Court held, as a matter of law, that the facts alleged in ATR's Fourth Claim for Relief "represent the type of failure to account for trust property that has traditionally been the hallmark of defalcation," and that Bonilla's misconduct as a director of the Delaware Holding Company was committed as a

fiduciary of ATR within the meaning of section 523(a)(4). 12(b)(6) Ruling at 5, 6.[2]

B. THE INJURY TO ATR AS A MINORITY SHAREHOLDER OF THE DELAWARE HOLDING COMPANY.

The findings of the Delaware Chancery Court are summarized as follows.[3]

1. Araneta and Bonilla.

Carlos Araneta is a wealthy Filipino businessman who operates an international family of courier and remittance companies bearing the initials "LBC." RJN Ex. 1 at *3-*4. Araneta "dominate[s] and control[s] LBC and is the ultimate manager for the thousands of employees working for LBC and the hundreds of locations owned by LBC around the globe." *Id.* at *3. Defendant Bonilla is the President of LBC Holdings USA Corporation and various related LBC companies located and operating in the United States. *Id.* at *3 n.2 and *4.

2. Araneta and ATR's Joint Venture in the Pre-Need Insurance Business.

Beginning in 1999, Araneta entered into a series of business arrangements with ATR designed to create a joint enterprise to purchase a controlling interest in a corporation (the "Pre-Need Company") that sold "pre-need" insurance policies designed to cover expenses (such as health and educational costs) that buyers of such policies expected to face in the future. *Id.* at *3. The parties saw "potential synergies in this industry between ATR's financial acumen and LBC's logistical network, which was well-positioned to attract Filipino customers who had traditionally purchased these policies." *Id.* ATR and Araneta executed two contracts—an "Undertaking Agreement" and a "Joint Venture Agreement"—that set out the terms of their joint venture relationship and, among other things, laid the groundwork for incorporation of the Delaware Holding Company. *Id.* Pursuant to their agreements, ATR and Araneta acquired equal shares that together totaled 80 percent of stock of the Pre-Need

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[2]For the Court's convenience, a copy of the 12(b)(6) Ruling is attached as Exhibit A to the Declaration of Long X. Do.

[3]Section B of the Factual Background is based entirely on the findings of the Delaware Chancery Court in its December 21, 2006, Memorandum Opinion.

Company. *Id.* Further part to their agreements, ATR advanced approximately $3.922 million to Araneta to cover his share of the purchase price of the Pre-Need Company. *Id.*

3. Formation of the Delaware Holding Company.

In return for the advance from ATR, Araneta pledged, in the Undertaking Agreement, to contribute his LBC companies and his newly acquired interest in the Pre-Need Company to the Delaware Holding Company and to issue ATR a 10 percent minority interest in the Delaware Holding Company. *Id.* After incorporation of the Delaware Holding Company in January 2000, Araneta presented ATR with 3,000 of its shares while personally retaining control over the residual 27,000 shares. *Id.* at *4. The Delaware Holding Company's chief assets consisted of the LBC companies that Araneta had contributed, which had a stated value of $35 million. *Id.* at *1. Araneta appointed and dominated the Delaware Holding Company's board of directors, which consisted of himself, Bonilla and Berenguer (Araneta's niece and the chief financial officer of a number of his LBC companies). *Id.* at *4.

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4. Looting of the Delaware Holding Company.

In November 2002, ATR decided to withdraw from the insurance venture with Araneta. *Id.* at *5. Although this decision was permissible under the terms of the parties' agreements, Araneta felt aggrieved by it. *Id.* Araneta's hostility towards ATR affected his management of the Delaware Holding Company adversely to ATR. *Id.* He withheld information from ATR about the Delaware Holding Company, effectively closed the lines of communication with ATR and stripped the Delaware Holding Company of its only "valuable assets" (*id.* at *4) by transferring the LBC companies out of the Delaware Holding Company to members of Araneta's family without informing ATR or permitting ATR to share *pro rata* in the proceeds. At page *6 of its Memorandum Opinion, the Delaware Chancery Court detailed Araneta's actions as follows:

> In the months that followed [ATR's decision to withdraw from the insurance venture], ATR repeatedly requested information on the condition of the Delaware Holding Company in which it still had nearly $4 million invested. But Araneta summarily rebuffed those requests. Araneta testified that any request ATR made for information during the entire 2003 calendar year went ignored because he was "no longer talking to them because [he was] upset with Mr. Arnaiz [the head of ATR]." Throughout the first half of that year, lawyers in the Philippines

> exchanged letters regarding the "ongoing fight" between Araneta and Arnaiz, but were unable to resolve the matter.
>
> Fed up, ATR, through its attorneys, sent a formal books and records demand letter to Araneta on July 18, 2003. In that letter, ATR exercised its right as a stockholder of a Delaware corporation to request financial statements of the Delaware Holding Company as well as documents showing the Delaware Holding Company's ownership of the [LBC companies] and Araneta's interest in the Pre-Need Company. In hopes of a response, ATR sent additional demand letters to the Delaware Holding Company's corporate secretary at its registered address and to Araneta's attorney in the Philippines on the same day as it sent its letter to Araneta. These additional demand letters sought to review the Delaware Holding Company's stock ledger, the records of all business transactions of the corporation, and the minutes of every meeting of the stockholders and directors of the Delaware Holding Company since its incorporation.
>
> [FN. 22] ATR copied Araneta's son, his lawyer, and the head of LBC's U.S. operations, defendant Bonilla, on this demand.
>
> Each of ATR's demand letters warned that ATR would file suit to protect its interests if its demands were denied. Yet, even knowing legal action was imminent, Araneta testified that he was "so angry with Mr. Arnaiz" that he "ignored these letters" and prevented ATR from gaining the information it sought. Starved for information, ATR filed an action under *8 Del. C.* § 220 in this court on October 27, 2003. But still irked by ATR's decision to sell its interest in [the pre-need insurance company], Araneta "deliberately ignored" that lawsuit and instructed Bonilla not to provide the requested information.
>
> [FN. 28] Specifically, when discussing the § 220 litigation with Bonilla, Araneta told him, "Don't mind it."
>
> Only after being ordered by this court to turn over the records requested by ATR did Araneta do so. On January 14, 2004, Araneta produced a "Compliance" that purported to include all available documents but totaled only nine pages and failed to include many essential corporate papers. The nine pages that Araneta did produce, however, included three documents that caused ATR great concern. Those documents-two balance sheets and a purported resolution of the board of directors-led ATR to believe that Araneta had conducted a de facto (and non-pro rata) liquidation of the Delaware Holding Company's assets and that Araneta was attempting to escape responsibility for that act . . . . These financial statements indicated that during the last nine months of 2003 Araneta stripped the Delaware Holding Company of the LBC [companies].

Id. at *6.

Araneta offered numerous excuses and purported justifications for his liquidation of the Delaware Holding Company at the trial in Delaware. Based on the evidence presented at trial, the Delaware Chancery Court rejected each of Araneta's defenses (see *id.* at *7-*14), variously characterizing them as "implausible excuses" (*id.* at *7), "brazen and abundant falsehoods" (*id.*), "appalling" (*id.*), "self-serving and untruthful" (*id.* at *13) and "ridiculous"

(*id.* at *16). Finding the evidence of Araneta's misfeasance "clear, and Araneta's attempts to distort that reality only make his conduct less tolerable," the Delaware Chancery Court concluded that Araneta, as a director of the Delaware Holding Company, breached his fiduciary duty—specifically, his duty of loyalty—to ATR. The Delaware Chancery Court found that "Araneta used his majority control and effective dominion over the Delaware Holding Company and its board of directors to engage in a course of unfair dealing that resulted in a de facto liquidation of corporate assets that enriched the Araneta family at the expense of the Delaware Holding Company and ATR." *Id.* at *17.

5. Bonilla's Breach of Fiduciary Duty to ATR.

Although Araneta was found to be chiefly responsible for the harm to ATR arising from the liquidation of the Delaware Holding Company, the Delaware Chancery Court devoted substantial attention to the role played by Bonilla and his liability to ATR for breach of his own fiduciary duty as a director of the Delaware Holding Company (as well as that of his co director, Berenguer).

Bonilla was a director of the Delaware Holding Company at all relevant times. *See id.* at *9. The Delaware Chancery Court found that Bonilla breached his fiduciary duty—specifically, his duty of loyalty—to ATR by consciously failing to monitor Araneta's misconduct, to protect ATR's interests, or to stop Araneta from liquidating the Delaware Holding Company's assets. Following are the Delaware Chancery Court's findings supporting these conclusions, from pages *19-*22 of its Memorandum Opinion.

> Under Delaware law, it is fundamental that a director cannot act loyally towards the corporation unless she tries-*i.e.*, makes a genuine, good faith effort-to do her job as a director. [Citation.] One cannot accept the important role of director in a Delaware corporation and thereafter consciously avoid any attempt to carry out one's duties.
>
> One of the most important duties of a corporate director is to monitor the potential that others within the organization will violate their duties. Thus, "a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board considers to be adequate, exists." [Citation.] Obviously, such a reporting system will not remove the possibility of illegal or improper acts, but it is the directors' charge to "exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary questions, so that

it may satisfy its responsibility." [Citation.] Thus, as the [Delaware] Supreme Court recently stated:

> *Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith. [Citation.]

From the testimony of the directors of the Delaware Holding Company, it is apparent that no reporting system was in place and that no other information systems or controls were ever considered, let alone implemented, by the Delaware Holding Company's board of directors. They did not even have regular board meetings. As a result, the directors were often unaware of corporate activities-despite how easy that would have been given the Delaware Holding Company's modest size . . . . Bonilla confirmed this fact, explaining that when the Delaware Holding Company's name was changed from LBC Global, Corp. to PMHI Holdings, Corp., he was never informed about the change, never voted to approve it, and did not even know what the initials PMHI in the new corporate name stood for at the time he signed the certificate of amendment as the corporation's authorized agent. [Citation.] Even when corporate activities involved them directly—as in the case of their supposed resignations from the board of directors—neither Berenguer nor Bonilla questioned the wisdom of Araneta's actions nor insisted that corporate procedures be followed. [Citation.]

Moreover, both Berenguer and Bonilla testified that they entirely deferred to Araneta in matters relating to the Delaware Holding Company . . . . Bonilla, the head of Araneta's U.S. operations . . . explain[ed] that to him Araneta and the Delaware Holding Company were basically one and the same and that he took the word of Araneta as being the word of the company. [Citation.] Moreover, when pressed regarding whether he would undertake an independent inquiry if told to act by Araneta, Bonilla responded, "Why should I ask him all these questions? He's telling me they have already agreed . . . . It's not like I'm going to go out there and check on him, doesn't make sense." [Citation.]

Based on these failures, neither Berenguer nor Bonilla can be said to have upheld their fiduciary obligations. Although it was Araneta who ran amok by emptying the Delaware Holding Company of its major assets, the other directors [Bonilla and Berenguer] did nothing to make themselves aware of this blatant misconduct or to stop it.

Put in plain terms, it is no safe harbor to claim that one was a paid stooge for a controlling stockholder. Berenguer and Bonilla voluntarily assumed the fiduciary roles of directors of the Delaware Holding Company. For them to say that they never bothered to check whether the Delaware Holding Company retained its primary assets and never took any steps to recover the LBC Operating Companies once they realized that those assets were gone is not a defense. To the contrary, it is a confession that they consciously abandoned any attempt to perform their

> duties independently and impartially, as they were required to do by law. Their behavior was not the product of a lapse in attention or judgment; it was the product of a willingness to serve the needs of their employer, Araneta, even when that meant intentionally abandoning the important obligations they had taken on to the Delaware Holding Company and its minority stockholder, ATR.
>
> When required by their office to be loyal to the Delaware Holding Company, Bonilla and Berenguer chose total fealty to Araneta's conflicting interests instead. Consequently, I find them jointly liable for Araneta's fiduciary obligations.

RJN Ex. 1 at *19-*21.

> All of the defendants [Araneta, Bonilla and Berenguer] will be jointly and severally liable for the amount of the judgment.

Id. at *22.

The Delaware Chancery Court's Final Judgment holds, "[h]aving been found jointly and severally liable for their breaches of fiduciary duty, judgment is entered against defendants Carlos R. Araneta, Hugo Bonilla and Liza Berenguer in the amount of **$24,490,422.50**." RJN Ex. 2 at 1.

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ARGUMENT

I. THE FINDINGS OF THE DELAWARE CHANCERY COURT DEMONSTRATE THAT BONILLA'S JUDGMENT DEBT TO ATR AROSE FROM "DEFALCATION WHILE ACTING IN A FIDUCIARY CAPACITY," AND IS NONDISCHARGEABLE.

A judgment debt that arises from "defalcation while acting in a fiduciary capacity" is nondischargeable under 11 U.S.C. §523(a)(4). "To prevail in a § 523(a)(4) action, the creditor must establish that (1) a fiduciary relationship existed and (2) a defalcation occurred." *In re Chapman*, 125 B.R. 284, 287 (Bankr. S.D. Cal. 1991) (citing *In re Short*, 818 F.2d 693 (9th Cir. 1986)); *see also Bugna v. McArthur* (*In re Bugna*), 33 F.3d 1054, 1057 (9th Cir. 1994). As this Court determined in denying Bonilla's motion to dismiss the Fourth Claim for Relief, the Delaware Chancery Court's findings detailing Bonilla's breach of his fiduciary duty to ATR meet these two requirements.

A. Bonilla was Acting in a Fiduciary Capacity within the Meaning of Section 523(a)(4).

The Court's 12(b)(6) Ruling establishes as a matter of law that the director-shareholder

relationship between Bonilla (as a director of the Delaware Holding Company) and ATR (as a minority shareholder of the Delaware Holding Company) constitutes a fiduciary relationship within the meaning of section 523(a)(4). Whether a debtor is a fiduciary under section 523(a)(4) is a question of federal law. *Lewis v. Scott* (*In re Lewis*), 97 F.3d 1182, 1185 (9th Cir. 1996). "The broad, general definition of 'fiduciary' is inapplicable in the dischargeability context." *Id.* Instead, as this Court noted in the 12(b)(6) Ruling, to be held to be a fiduciary under section 523(a)(4), the "debtor must have been subject to the duties of a trustee before, and without reference to, the wrongdoing that gave rise to the debt," "the duties imposed on the debtor must be those imposed on the trustee of an express or technical trust," and "there must be an identifiable trust *res*, identifiable beneficiaries, and the debtor must be subject to the duties of loyalty, good faith, and honesty in caring for the trust *res*." 12(b)(6) Ruling at 2 (citing *In re Lewis*, 97 F.3d at 1185-86 and n.1; *Miramar Res., Inc. v. Shultz* (*In re Shultz*), 208 B.R. 723, 728 (Bankr. M.D. Fla. 1997)). In determining whether a debtor was subject to these types of duties, a court looks to applicable state law. *See* 12(b)(6) Ruling at 2 ("Whether a debtor is subject to the duties just described is primarily a matter of state law") (citing *In re Lewis*, 97 F.3d at 1185)).

The Court looked to Delaware law to determine whether Bonilla, as a director of a Delaware corporation, was subject to the types of duties described above that would make him a fiduciary under section 523(a)(4). As the Court stated, "[n]umerous Delaware decisions refer to directors as trustees, and impose on directors the highest duties of loyalty, honesty, and fair dealing in all matters concerning the management of corporate assets," and "impose this fiduciary duty prior to, and without reference to, any misconduct by the director." *Id.* at 3 (citing *Hynson v. Drummond Coal Co., Inc.*, 601 A.2d 570 (Del. Ch. 1991); *Keenan v. Eshleman*, 2 A.2d 904, 908 (Del. Ch. 1938); *Bodell v. Gen. Gas & Elec. Corp.*, 132 A. 442, 447 (Del. Ch. 1926)). The Court thus concluded, "Delaware case law clearly identifies the fiduciary duties of a corporate director, the trust *res* (all corporate assets), and the beneficiaries of the trust (the corporation and its shareholders)." *Id.*

Recognizing that the Ninth Circuit mentions "the fiduciary relationship must be one

arising from an express or technical trust" (*In re Lewis*, 97 F.3d at 1185), this Court undertook a closer examination whether "this mean[s] that in addition to preexisting the wrong, the fiduciary duty must be identical to that of a trustee in every technical respect." *Id.* at 4. Holding that section 523(a)(4) does not require such a strictly technical construction, the Court "conclude[d] that the fiduciary duty [under section 523(a)(4)] must preexist the trust, and must be *substantially similar* to the role of a trustee, in that there must be a trust *res*, identifiable beneficiaries, and clear notice of the duties of loyalty, honesty, and fair dealing toward the beneficiaries in all matters affecting the trust *res*." *Id.* at 4 (emphasis in original). The Court noted that the decision in *In re Lewis*, from which the "express or technical trust" language comes, held partners to be fiduciaries under section 523(a)(4) upon the basis of state-court decisions that imposed on partners the duties of loyalty, honesty, and fair dealing. *Id.* (citing *In re Lewis*, 97 F.3d at 1186). The Court further observed that "[o]ne of the decisions *In re Lewis* relied upon described the duties of a partner as merely 'similar to a trustee's,' and the other decisions cited failed to use the term trustee at all in describing the duties of a partner." *Id.* at 5 (citing *Desantis v. Dixon*, 236 P.2d 38, 41 (Ariz. 1951); *Jerman v. O'Leary*, 701 P.2d 1205, 1210 (Ariz. 1985); *Carrasco v. Carrasco*, 422 P.2d 411, 413 (Ariz. App. 1967)). Finally, the Court highlighted that the Ninth Circuit in *In re Lewis* noted with approval language in Collier stating that the duties of the fiduciary need only be "substantially similar" to those imposed on trustees. *Id.* (quoting *In re Lewis*, 97 F.3d at 1186 n.1).

Reiterating its finding that "the director of a corporation organized under Delaware law is subject to duties substantially similar to those imposed on the trustee of an express or technical trust, and those duties arise before and without reference to any wrongdoing," the Court held as a matter of law that "[t]he director of a Delaware corporation is therefore a fiduciary within the meaning of section 523(a)(4)." *Id.* In other words, Bonilla was acting as a fiduciary within the meaning of section 523(a)(4) when he breached his fiduciary duty to ATR, as determined by the Delaware Chancery Court.

B. Bonilla Committed Defalcation While Acting as a Fiduciary to ATR.

The Court's 12(b)(6) Ruling also establishes as a matter of law that, in breaching his fiduciary duty to ATR as determined by the Delaware Chancery Court, Bonilla committed defalcation within the meaning of section 523(a)(4). As the Court recognized in its 12(b)(6) Ruling, Delaware law imposes on corporate directors such as Bonilla "the highest duties of loyalty, honesty, and fair dealing in all matters concerning the management of corporate assets." 12(b)(6) Ruling at 3. To be sure, as the Delaware Chancery Court stated, "[o]ne of the most important duties of a corporate director is to monitor the potential that others within the organization will violate their duties. Thus, 'a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board considers is adequate, exists.'" RJN Ex. 1 at *19 (quoting *In re Caremark Int'l, Inc. Deriv. Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996)). "Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

By way of summary, therefore, the Delaware Chancery Court found Bonilla breached his fiduciary duty to ATR by:

(1) "allow[ing] Araneta to do whatever he wanted, without any examination of whether his conduct benefited the Delaware Holding Company and all of its stockholders, rather than simply Araneta personally" (RJN Ex. 1 at *1);

(2) treating "Araneta and the Delaware Holding Company [as] basically one and the same and [taking] the word of Araneta as being the word of the company" (*id.* at *20);

(3) never "question[ing] the wisdom of Araneta's actions nor insist[ing] that corporate procedures be followed" (*id.*);

(4) "consciously abandon[ing] any attempt to perform [his] duties independently and impartially, as [he was] required to do by law" (*id.* at *21);

(5) evincing a "willingness to serve the needs of [his] employer, Araneta, even when

that meant intentionally abandoning the important obligations they had taken on to the Delaware Holding Company and its minority stockholder, ATR" (*id.*);

(6) "never [taking] any steps to recover the LBC Operating Companies once [he] realized that those assets were gone" (*id.*); and

(7) "act[ing] as—no other word captures it so accurately—[a] stooge[] for Araneta, seeking to please him and only him, and having no regard for [his] obligations to act loyally towards the corporation and all of its stockholders" (*id.* at *1).

Bonilla's breach of his fiduciary duty to ATR amounts to defalcation within the meaning of section 523(a)(4), which "is broadly defined to include any behavior by a fiduciary, including innocent, negligent, and intentional defaults of fiduciary duty resulting in failure to provide a complete accounting." *In re Briles*, 228 B.R. 462, 467 (Bankr. S.D. Cal. 1998). This Court so held in its 12(b)(6) Ruling, finding as a matter of law that Bonilla's misconduct, as determined by the Delaware Chancery Court, "constitute a complete failure to take any action to preserve the assets of the corporation . . . [and] represent the type of failure to account for trust property that has traditionally been the hallmark of defalcation." 12(b)(6) Ruling at 6.

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II. THE FINDINGS OF THE DELAWARE CHANCERY COURT ARE ENTITLED TO PRECLUSIVE EFFECT IN THIS ADVERSARY PROCEEDING.

In denying Bonilla's motion to dismiss ATR's Fourth Claim for Relief, the Court treated the Delaware Chancery Court's findings relating to Bonilla's breach of fiduciary duty as true for purposes of a Rule 12(b)(6) motion. *See* 12(b)(6) Ruling at 2 n.1. The Court observed that "Plaintiff is not urging that the decision of the Delaware court be given issue-preclusive effect at this time." *Id.* By this Motion, ATR now requests that the Court give preclusive effect to the findings of the Delaware Chancery Court's Memorandum Opinion. The case law compels application of collateral estoppel here.

The preclusive force of a state-court judgment is mandated by the statutory requirement that the federal courts accord such judgments "full faith and credit." 28 U.S.C. §1738; *see also Gayden v. Nourbakhsh (In re Nourbakhsh)*, 67 F.3d 798, 801 (9th Cir. 1995). It is

also rooted in the longstanding rule precluding federal-court review of state-court judgments known as the *Rooker-Feldman* doctrine. *See Rooker v. Fid. Trust Co.*, 263 U.S. 413 (1923); *Dist. of Columbia Court of Appeals v. Feldman*, 460 U.S. 462 (1983) (federal court precluded from exercising jurisdiction over collateral attack on state court judgment, even when state court judgment may be in error). The doctrine of collateral estoppel (also referred to as issue preclusion) applies in the bankruptcy courts, and specifically applies in nondischargeability proceedings such as the instant adversary proceeding. *Grogan v. Garner*, 498 U.S. 279, 284-85 & n.11 (1991) ("We now clarify that collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to [11 U.S.C.] § 523(a)"); *Bugna*, 33 F.3d at 1056-57 (applying collateral estoppel in adversary proceeding under 11 U.S.C. §523(a)(4)).

In determining the collateral estoppel effect of the Delaware Chancery Court's Memorandum Opinion and Final Judgment, this Court must apply Delaware's law of collateral estoppel. *See Marrese v. Am. Acad. of Orthopaedic Surgeons*, 470 U.S. 373, 379-82 (1985) (holding 28 U.S.C. §1738 "directs a federal court to refer to the preclusion law of the State in which judgment was rendered"); *In re Moore*, 186 B.R. 962, 968 (Bankr. N.D. Cal. 1995) ("[A] federal court must give a state court judgment the same preclusive effect it would receive in that state"). Under Delaware law, "the doctrine of collateral estoppel provides repose by preventing the relitigation of an issue of fact previously decided. The test for applying the collateral estoppel doctrine requires that (1) a question of fact essential to the judgment (2) be litigated and (3) determined (4) by a valid and final judgment." *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 520 (Del. S. Ct. 1999); *see also West Coast Mgmt. & Capital, LLC v. Carrier Access Corp.*, 914 A.2d 636, 643 (Del. Ch. 2006) ("Issue preclusion applies if: (1) the issue sought to be precluded is the same as that involved in the prior action; (2) that issue was actually litigated; (3) the issue was determined by a final and valid judgment; and (4) the determination was essential to the prior judgment").[4]

[4]To the extent that California law of collateral estoppel applies because ATR has (continued . . .)

All of the elements for application of collateral estoppel are met here. In the Delaware action, ATR asserted a claim directly against Bonilla for breach of fiduciary duty, namely, a corporate director's duty of loyalty to the corporation's stockholders. Based on the evidence presented at trial, the Delaware Chancery Court found that Bonilla did in fact breach his fiduciary duty to ATR. Bonilla's breach of his fiduciary duty to ATR was litigated through trial and was essential to the Delaware Chancery Court's Memorandum Opinion and Final Judgment. The Memorandum Opinion and Final Judgment are now final, having been affirmed by the Delaware Supreme Court. *See* RJN Ex. 3.

In this adversary proceeding, the same breach of Bonilla's fiduciary duty to ATR found by the Delaware Chancery Court forms the basis of ATR's Fourth Claim for Relief. The Fourth Claim for Relief alleges:

> Bonilla's failure—as found by the Delaware Chancery Court—to monitor Araneta's actions, to prevent him from removing assets from the Delaware Holding Company to his family members without consideration, or to take any steps to protect ATR's interest as a minority shareholder, facilitated and enabled Araneta's wrongful transfer of assets from the Delaware Holding Company, resulting in the misappropriation of funds held in a fiduciary capacity . . . . As a result of these actions, Bonilla's Judgment Debt to ATR arises from "fraud or defalcation while acting in a fiduciary capacity," within the meaning of 11 U.S.C. Section 523(a)(4) and therefore should be excepted from discharge. (Compl. ¶¶75-76)

Accordingly, the Delaware Chancery Court's findings that Bonilla breached his fiduciary duty to ATR bars Bonilla from relitigating that issue in this adversary proceeding.

It is irrelevant that the Delaware Chancery Court did not specifically find that Bonilla committed defalcation while acting in a fiduciary capacity within the meaning of the Bankruptcy Code. As one bankruptcy court has noted:

(. . . continued)
entered the Delaware Chancery Court's Final Judgment as a sister-state judgment in California, the same analysis would be required. California's law of collateral estoppel is materially the same as that of Delaware. *See Bugna*, 33 F.3d at 1057 ("Under [California] law, collateral estoppel bars relitigation when '(1) the issue decided in the prior action is identical to the issue presented in the second action; (2) there was a final judgment on the merits; and (3) the party against whom estoppel is asserted was a party . . . to the prior adjudication'") (quoting *Garrett v. City and County of San Francisco*, 818 F.2d 1515, 1520 (9th Cir. 1987)).

> [R]egardless of whether Judge Brooks [who had decided the case giving rise to the underlying debt] specifically concluded that Shultz [a corporate director] owed Miramar [a Delaware corporation] a fiduciary duty which satisfies §532(a)(4), so long as factual findings were made which permit that determination, this Court is bound by those findings and is barred from proceeding with relitigation of the same facts. (*In re Zachary Shultz*, 205 B.R. 952, 955 (Bankr. M.D. Fla. 1997))

What matters, instead, is that the findings of the Delaware Chancery Court, considered in conjunction with applicable bankruptcy and Delaware law, lead to the determination that Bonilla's judgment debt is nondischargeable under section 523(a)(4). As noted above, this Court has already decided the legal component of that determination in its 12(b)(6) Ruling. The factual component of that determination was made by the Delaware Chancery Court and is entitled to preclusive effect here. Accordingly, ATR is entitled to summary judgment on its Fourth Claim for Relief that Bonilla's judgment debt to ATR in the amount of $24,490,422.50, plus accrued post-judgment interest of $490,647.16, is nondischargeable pursuant to 11 U.S.C. §523(a)(4).

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CONCLUSION

For the foregoing reasons, ATR urges that the Court grant its Motion for Summary Judgment on the Fourth Claim for Relief.

DATED: November 15, 2007.

Respectfully,

MICHAEL J. BAKER
WILLIAM J. LAFFERTY
LONG X. DO
HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN
A Professional Corporation

By: _____
WILLIAM J. LAFFERTY

Attorneys for Plaintiffs ATR-KIM ENG FINANCIAL CORPORATION and ATR-KIM ENG CAPITAL PARTNERS, INC.

Entered on Docket
December 20, 2007
GLORIA L. FRANKLIN, CLERK
U.S BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

Signed and Filed: December 17, 2007

THOMAS E. CARLSON
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re HUGO NERY BONILLA, Debtor.	Case No. 07-30309 TEC Chapter 7
ATR-KIM ENG CAPITAL PARTNERS, INC., and ATR-KIM ENG FINANCIAL CORPORATION, Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	Adv. Proc. No. 07-3079 TC

MEMORANDUM RE DEFENDANT'S MOTION FOR RECONSIDERATION AND PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

I. Motion for Reconsideration

Defendant seeks reconsideration of the denial of his motion to dismiss Plaintiffs' fourth cause of action for failure to state a claim upon which relief can be granted. In so moving, Defendant

EXHIBIT J

contends that this court made a manifest error of law in determining that the director of a Delaware corporation is a "fiduciary" within the meaning of section 523(a)(4) of the Bankruptcy Code.

Defendant first argues that this court did not give proper deference to the decision of the Ninth Circuit in Cal-Micro, Inc., v. Cantrell (In re Cantrell), 329 F.3d 1119 (9th Cir. 2003). Because Cantrell relied upon a California Supreme Court decision stating that a corporate officer is an agent rather than a trustee under California law, I find Cantrell to be of little relevance to the present case involving a Delaware director.

Defendant next argues that the decisions of the Delaware Supreme Court imposing trustee-like duties on corporate directors are inapposite because they involved instances in which the corporation was insolvent or the director improperly benefitted from the act in question. This argument is unpersuasive for two reasons.

First, Defendant cites no Delaware decision holding that a corporate director has trustee-like duties *only* where the corporation is insolvent or the director benefits. At the same time, a decision of the Delaware Chancery Court imposed trustee-like duties on corporate directors where there was no showing of insolvency or improper benefit. Bodell v. General Gas & Electric Corp., 132 A. 442, 447 (Del. Ch. 1926).

Second, a recent decision of the Delaware Supreme Court holds that the fiduciary duties owed shareholders are the same as those owed creditors upon insolvency.

> It is well settled that directors owe fiduciary duties to the corporation. When a corporation is *solvent*, those duties may be enforced by its shareholders, who have standing to bring *derivative* actions on behalf of the corporation because they are the ultimate beneficiaries of the corporation's growth and increased value. When a corporation is *insolvent*, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value.
>
> Consequently, the creditors of an *insolvent* corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties. The corporation's insolvency "makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value." Therefore, equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation. Individual creditors of an insolvent corporation have the same incentive to pursue valid derivative claims on its behalf that shareholders have when the corporation is solvent.

North American Catholic Educational Programming Foundation, Inc., v. Gheewalla, 930 A.2d 92, 101-02 (Del. 2007) (emphasis and quotations in original)(footnotes omitted). In this context, the Delaware decisions holding that directors become trustees for creditors upon insolvency become direct support for the conclusion that directors are trustee for shareholders while the corporation is solvent.

Defendant argues finally that this court erred in relying upon the "substantially similar" test stated in Lewis v. Scott (In re Lewis), 97 F.3d 1182 (9th Cir. 1996), asserting that Lewis is an "anomaly" among Ninth Circuit decisions otherwise interpreting section 523(a)(4) very narrowly. This court is persuaded that the functional approach of Lewis is sound. Reliance on formalistic taxonomy has lead the Ninth Circuit to the somewhat curious conclusion that a director of a California corporation is a

fiduciary for creditors when the corporation is insolvent,[1] but is not a fiduciary for the director's prime constituents, shareholders, when the corporation is not insolvent.[2] North American Catholic, decided by the court most widely recognized for its expertise in corporate governance, suggests that a functional, interest-based approach is appropriate for any analysis of the fiduciary duties of a director under Delaware law.

II. Plaintiffs' Motion for Summary Judgment

Plaintiffs seek summary judgment on their fourth cause of action based on the preclusive effect of the Chancery Court judgment. Defendant contends that issue preclusion is inappropriate because the factual issues relevant to the fourth cause of action are not identical to those decided in the state-court action. This argument is unpersuasive.

This court having decided that Defendant is a "fiduciary" as a matter of law, the relevant fact question under section 523(a)(4) is whether his wrongful acts amounted to a "defalcation." The state court made detailed findings to the effect that Defendant consciously failed to take the minimum steps legally required of him as a director to protect corporate assets. These findings represent a finding of defalcation: Defendant, while acting in a fiduciary capacity was unable to account for property placed under

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[1] Lawrence T. Lasagna, Inc. v. Foster, 609 F.2d 392, 396 (9th Cir. 1979)(director of insolvent corporation organized under California law is fiduciary for purposes of section 35(a)(4), predecessor to section 523(a)(4)); Nahman v. Jacks (In re Jacks), 266 B.R. 728, 737 (9th Cir. BAP 2001).

[2] Cantrell, 329 F.3d at 1127.

his charge, and the property was lost due to Defendant's failure to follow the instructions imposed upon him by law regarding the protection of that property. See Otto v. Niles (In re Niles), 106 F.3d 1456, 1460-62 (9th Cir. 1997).

****END OF MEMORANDUM****

Court Service List

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Entered on Docket
January 02, 2008
GLORIA L. FRANKLIN, CLERK
U.S BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

Signed and Filed: January 02, 2008

THOMAS E. CARLSON
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re HUGO NERY BONILLA, Debtor.	Case No. 07-30309 TEC Chapter 7
ATR-KIM ENG CAPITAL PARTNERS, INC., and ATR-KIM ENG FINANCIAL CORPORATION, Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	Adv. Proc. No. 07-3079 TC Date: January 18, 2008 Time: 9:30 a.m. Crtm: 235 Pine St., 23rd Fl. San Francisco, CA

ORDER DENYING DEFENDANT'S MOTION FOR RECONSIDERATION AND GRANTING PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT ON FOURTH CAUSE OF ACTION

The court held a hearing on December 14, 2007 on Defendant's Motion to Reconsider Order Denying Defendant's Motion to Dismiss Plaintiff's Fourth Cause of Action and on Plaintiffs' Motion for Summary Judgment on Fourth Cause of Action. William J. Lafferty appeared for Plaintiffs. Iain A. Macdonald appeared for Defendant.

EXHIBIT K

Upon due consideration, and for reasons stated on the record at the hearing and in the accompanying memorandum, the court hereby orders as follows.

(1) Defendant's motion for reconsideration is denied.

(2) The court grants Plaintiffs' motion for summary judgment on the fourth claim for relief and determines that the $24,981,069.66 judgment entered on January 10, 2007 in Delaware Court of Chancery Case No. CIV.A. 489 is excepted from discharge under 11 U.S.C. § 523(a)(4).

(3) The court will enter a separate partial judgment on the fourth claim for relief, and will direct entry of final judgment as to this claim.

(4) Upon stipulation of the parties on the record at the hearing, the court establishes the following schedule regarding Defendant's Motion for Stay Pending Appeal of the Partial Judgment:

(a) Defendant shall file and serve a Motion for Stay on or before January 4, 2008.

(b) Plaintiffs shall file and serve a response to the Motion on or before January 14, 2008.

(c) A hearing on the motion for stay pending appeal is set for January 18, 2008 at 9:30 a.m.

****END OF ORDER****

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Entered on Docket
January 02, 2008
GLORIA L. FRANKLIN, CLERK
U.S BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

Signed and Filed: January 02, 2008

THOMAS E. CARLSON
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re HUGO NERY BONILLA, Debtor.	Case No. 07-30309 TEC Chapter 7
ATR-KIM ENG CAPITAL PARTNERS, INC., and ATR-KIM ENG FINANCIAL CORPORATION, Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	Adv. Proc. No. 07-3079 TC

PARTIAL SUMMARY JUDGMENT ON FOURTH CAUSE OF ACTION AND RULE 54(b) CERTIFICATION

The court held a hearing on December 14, 2007 on Defendant's Motion to Reconsider Order Denying Defendant's Motion to Dismiss Plaintiff's Fourth Cause of Action and on Plaintiffs' Motion for Summary Judgment on Fourth Cause of Action. William J. Lafferty appeared for Plaintiffs. Iain A. Macdonald appeared for Defendant.

EXHIBIT L

Upon due consideration, and for reasons stated on the record at the hearing and in the accompanying memorandum, the court hereby enters partial summary judgment as follows.

(1) Summary judgment is entered on Plaintiffs' fourth claim for relief that the $24,981,069.66 judgment entered on January 10, 2007 in Delaware Court of Chancery Case No. CIV.A. 489 is excepted from discharge under 11 U.S.C. § 523(a)(4).

(2) Pursuant to Federal Rule of Civil Procedure 54(b), incorporated by Fed. R. Bankr. Proc. 7054(a), the court having determined that there is no just reason for delay, the court expressly directs immediate entry of final judgment on Plaintiffs' fourth claim for relief.

****END OF PARTIAL SUMMARY JUDGMENT****

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Attorneys for Appellant,
HUGO NERY BONILLA

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In Re: HUGO NERY BONILLA, Debtor.	District Case No. CV 08-1062 SC
ATR-KIM ENG FINANCIAL CORPORATION AND ATR-KIM ENG CAPITAL PARTNERS, INC., Plaintiffs, vs. HUGO NERY BONILLA, Defendant.	Adv. Proc. No. 07-03079 Bankruptcy Case No. 07-30309 Chapter 7 CERTIFICATE OF SERVICE

I, the undersigned, state that I am employed in the City and County of San Francisco, State of California; that I am over the age of eighteen years and not a party to the within action; that my business address is Two Embarcadero Center, Suite 1670, San Francisco, California, 94111-3930.

On the date hereon, I served the foregoing document(s) described as:

REQUEST OF APPELLANT HUGO NERY BONILLA FOR CERTIFICATION OF APPEAL TO THE NINTH CIRCUIT COURT OF APPEAL; and

NOTICE OF REQUEST OF APPELLANT HUGO NERY BONILLA FOR CERTIFICATION OF APPEAL TO THE NINTH CIRCUIT COURT OF APPEAL

on the following on this 26th day of February, 2008, at San Francisco, California:

William J. Lafferty, Esq.
Howard Rice Nemerovski Canady
Falk & Rabkin, 7th Floor
Three Embarcadero Center
San Francisco, CA 94111-4024

___ **(By Personal Service)** By causing a true copy if said document(s), enclosed in a sealed envelope and addressed below, to be hand delivered.

X **(By First Class U.S. Mail)** By causing a true copy if said document(s), enclosed in a sealed envelope addressed as below and with postage thereon fully prepared, to be placed in United States mail at San Francisco, California.

___ **(By Federal Express)** By causing a true copy if said document(s), enclosed in appropriate packaging and addressed as below and with delivery fee thereon fully prepaid, to be delivered to a Federal Express.

___ **(By Facsimile)** By causing a true copy if said document(s),to be transmitted by facsimile copying machine to telephone numbers shown below, known by or represented to me to be the receiving telephone number for facsimile copy transmission of the parties/persons/ firms listed below. The transmission was reported as complete and without error.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that I am employed in the office of a member of the bar of this Court, at whose direction the service was made and that the foregoing is true and correct.

/s/
Shirley P. Pathross